VOLUME I

LEGAL SOLUTIONS TO THE CONFLICT BETWEEN EQUITY OF INCOME REDISTRIBUTION AND ECONOMIC EFFICIENCY OF TAXATION IN RELATION TO PERSONAL INCOME TAX LAW IN THAILAND AND THE UNITED KINGDOM

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ABSTRACT OF THESIS

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The purpose of this thesis is to examine and compare Thai and UK income tax laws to establish how they cause conflict between equity of income redistribution and efficiency of taxation. This thesis also aims to validate theories that optimal tax structures and efficient tax legislation and administration can resolve the conflict. There are six chapters.

Chapter One reviews concepts of equity and efficiency. Research in the components of income tax law to establish optimal tax structures (which require a limited policy, simple and certain law, and prevention of tax avoidance) offers a novel way to resolve the conflict.

Chapter Two concerns a progressive rate structure. At present, there are few low marginal tax rates, resulting from revenue targets, politics, tax avoidance, and few top-rate taxpayers. They achieve only some redistribution, but promote efficiency. A system of two tax-rate schedules is proposed, i.e. one for low incomes and another for high incomes. Each contains optimal marginal rates to achieve greater redistribution and still promote efficiency.

Chapter Three involves a tax base. Tax reliefs narrow the base, affecting equity and efficiency. An optimal base is therefore proposed, with a broad base, adjustment of personal allowances to cover costs of living and inflation, a phase-out of allowances, the abolition of standard deduction of expenses, and criteria for abolishing certain tax expenditures.

Chapter Four considers the tax treatment of married couples. The Thai joint-taxation system needs to increase efficiency yet maintain equity. The UK individual-taxation system needs to reduce inequity while maintaining efficiency. To strike a balance between equity and efficiency, the integration of joint and individual taxation, changes in the structures of tax rates and reliefs, and prevention of tax avoidance are proposed.

Chapter Five analyzes legislative process, primary and secondary legislation, judicial interpretation, judicial and statutory anti-avoidance rules, administrative practice and methods of tax collection. Improvements in these are proposed to achieve and ensure efficiency in tax legislation and administration which requires simple and certain tax legislation and simple, certain and convenient methods of tax collection. Efficiency in tax legislation and administration would encourage efficiency of taxation and further promote equity.

Chapter Six brings together the main findings in the previous chapters to establish optimal tax structures and efficient tax legislation and administration.

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Abbreviations

ATR	Average tax rate
ATRs	Average tax rates
CCCT	Civil and Commercial Code of Thailand
CA 2001	Capital Allowances Act 2001
CGT	Capital gains tax
CPA 2004	Civil Partnership Act 2004
CIT	Comprehensive income-tax base, or comprehensive income tax
CTC	Child Tax Credit
CT	Corporation tax
HMRC	HM Revenue and Customs
HSPR	High single positive rate
IFS	Institute for Fiscal Studies
IMF	International Monetary Fund
ITEPA 2003	Income Tax (Earnings and Pensions) Act 2003
ITTOIA 2005	Income Tax (Trading and Other Income) Act 2005
MSPR	Moderate single positive rate
MTR	Marginal tax rate
MTRs	Marginal tax rates
OECD	Organization for Economic Co-Operation and Development
ONS	Office for National Statistics
PAYE	Pay As You Earn
PIT	Personal income tax
RCT	Revenue Code of Thailand
RD	Revenue Department of Thailand
OSMTRs	Optimal statutory marginal tax rates
OTBs	Optimal tax bands
TA 1988	Income and Corporation Taxes Act 1988
TLRC	Tax Law Review Committee
TMA	Taxes Management Act 1970
VAT	Value Added Tax

Chapter One (Introductory Part)

Underlying Concepts of Equity and Efficiency, and Proposed Thesis

1. Introduction

This chapter explains reasons for undertaking this thesis and its objectives. It also gives a reason for a comparison between the personal income tax systems of Thailand and the UK. As this thesis will examine the conflict between equity and efficiency caused by personal income tax ('PIT'), a general survey of the underlying concepts of equity and efficiency is also conducted.

Additionally, this chapter explains the reason why this thesis is confined to PIT. It also clarifies what PIT covers or encompasses. As this thesis involves research in law to establish the optimal components of PIT, this will offer a novel/original way to reduce the conflict between equity and efficiency. This originality will be discussed in greater detail in this chapter.

Finally, this chapter will discuss three significant factors which should be attached to the proposed optimal components of PIT, the possibility of adaptation of the proposed models elsewhere, and the efficacy of solutions under the proposed models.

2. Definitions of key terms

'Income tax' or 'personal income tax' means a tax levied on the income of individuals and of other entities which are deemed to be individuals, such as trustees, personal representatives and partnerships (under UK law)[1], non-juristic partnerships and a non-juristic body of persons (under Thai law).

'Optimal taxation' means the design of tax systems to minimize excess burdens/deadweight loss while achieving a socially desirable redistribution of income, or to strike the correct balance between equity and efficiency.[2]

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[1] Michael Tookey, Revenue Law, 4th ed., (London: Old Bailey Press, 2003), 1.

[2] C.V. Brown and P.M.Jackson, Public Sector Economics, 3rd ed. (Oxford: Basil Blackwell, 1986), p.459; Simon James, A Dictionary of Taxation (Cheltenham: Edward Elgar Publishing Limited, 1998), 112; and James Alm, "What is an optimal tax system? ", National Tax Journal Vol. XLIX, No.1, 120.

'Optimal tax structures' mean the components of substantive tax law that are designed to strike a balance between equity and efficiency.[3]

'Equity of income redistribution' (**'equity'**) means a more equal distribution of income to reduce income inequality by requiring the rich to pay not only a higher amount but also a higher proportion of their income in tax than the poor.[4]

'Economic efficiency of taxation' (**'efficiency'**) means a small cost of collection and administration as a proportion of revenue raised, a low cost of taxpayers' compliance, and minimum distortion in taxpayers' economic behavior or in resource allocation (or minimum distortionary/disincentive effects).[5]

'Tax avoidance' means any lawful action that reduces tax liability "without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in that liability."[6] (More discussion (such as the distinction between (acceptable) tax planning and (unacceptable) tax avoidance, and the distinction between tax avoidance and tax evasion will be given in Chapter Five).

'Tax evasion' means an illegal way of not paying tax rightfully due to the government.[7] (More discussion (such as the offence of fraudulent evasion of income tax) will be given in Chapter Five).

3. Rationale for undertaking the thesis

In 1997, Thailand had an economic crisis. At that time, the Thai government used many fiscal policies and measures to stimulate the economy of the country. The Thai government used PIT measures for this purpose, for example, the use of a zero-rate bracket for the first 50,000 baht of taxable/net income, and the extensive use of tax expenditures (e.g. an increase in the amount of itemized deduction).

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[3] In this thesis, the components of PIT law are taken into account and designed.
[4] More discussion will be made in subsection 6.3.
[5] Simon James and Christopher Nobes, The Economics of Taxation, 7th ed., (Essex: Pearson Education, 2000), pp.16-17; Lucy Chennells, "The Windfall Tax", Fiscal Studies, Vol. 18, No. 3 (1997), 287; Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, 4th ed., (New York: McGraw-Hill Book, 1984), 290; and Richard G. Lipsey and Colin Harbury, First Principles of Economics, 2nd ed., (Oxford: Oxford University Press, 1992), 229-230.
[6] John Tiley, Revenue Law, 5th ed., (Oxford: Hart Publishing, 2005), 94 and 97.

The above tax measures stimulated the economy of the country since people had higher disposable income after tax. However, these measures adversely affected equity and efficiency. In terms of inequity, the poorest did not benefit from tax expenditures; and the rich received more tax benefit from a zero-rate bracket and the increase in the amount of itemized deductions as compared to the poor. In terms of inefficiency, tax expenditures provided tax loopholes and distorted resource allocation; and a zero-rate bracket and tax expenditures reduced tax revenues.

Therefore, I wish to research into the way in which PIT law can be used efficiently to have positive effects on both equity and efficiency, i.e. a more equal distribution of income while raising revenue for the government with low administrative and compliance costs, and minimum distortion in resource allocation.

4. Objectives of the thesis

In addition to being used as an economic stimulator, PIT can be used to redistribute income and to raise revenue for a government. PIT would achieve the redistributive objective, if it worked under requirements for equity. Meanwhile, if PIT worked under requirements for efficiency, it would achieve the revenue target.

However, the functions of PIT under equity and efficiency conflict with each other. If PIT were made more equitable, it could reduce efficiency. Conversely, if PIT were made more economically efficient, that could undermine equity.

It is argued that it is very difficult to find a tax system that can achieve all the opposing objectives at the same time.[8] As Wald notes,

> "Yet success in the art of making tax policy is never achieved by pursuing only a single goal, such as taxpayer equity, while neglecting others; a determined effort is required to seek out taxes that satisfy, to the maximum extent possible, all the pertinent – and sometimes conflicting – objectives of taxation, with the aim of having the best possible system of taxation in the given situation."[9]

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[7] Tax Law Review Committee ('**TLRC**'), Tax Avoidance (London: The Institute for Fiscal Studies ('**IFS**'), 1997), 1.

[8] Haskell P. Wald, Taxation of Agricultural Land in Underdeveloped Economies (Cambridge: Harvard University Press, 1959), 85.

[9] ibid.p.85

Despite the difficulty in finding a tax system that can satisfy all conflicting objectives, this thesis attempts to suggest desirable solutions. The objective of this thesis is to examine and compare the components of current PIT law in Thailand and the UK to establish to what extent they cause the conflict between equity and efficiency. This thesis also seeks out a solution to the conflict, and it aims to validate hypotheses that : (a) the optimal components of substantive PIT law (or optimal tax structures) and (b) efficiency in tax legislation and administration could reduce the conflict and bring about positive effects on both equity and efficiency simultaneously.

5. Rationale for comparison between the PIT systems of the UK and Thailand

The rationale for the comparison is to seek differences in the main components of PIT and in tax legislation and administration between the PIT system of a developed country (the UK) and that of a developing country (Thailand). These differences will show which system has:

(a) better components to achieve equity and efficiency, and

(b) more efficient tax legislation and administration.

The merits of one system are likely to be models for the reform of tax components and for the improvement of tax legislation and administration of another system, in order to bring about positive effects on equity and efficiency. Meanwhile, the demerits of one system should not be imitated by another to avoid negative effects on equity and efficiency. If any component of one system is found to have both merits and demerits (after comparing with another system), its demerits should be improved to establish an optimal component to strike a balance between equity and efficiency.

It is supposed that there must be differences between the PIT systems of both countries. This supposition is based on the facts that (a) the UK is a developed country, whereas Thailand is a developing country, and (b) the PIT system of the UK has been developed for a longer period than that of Thailand.

As regards (a), the UK is more likely to have complex PIT law than Thailand. A developed country has complex society, sophisticated business environment, and rapid and continuous commercial development. Consequently, it is inevitable that the UK will frequently introduce complex PIT law to keep up with and respond to these societal and economic activities. Thuronyi supports the view that "the U.S has the most complex [tax] legislation …….., followed by countries like Australia, Canada, and the UK." [10] Meanwhile, Thailand has less complex social and economic activities; consequently, it has simpler PIT law. Thuronyi supports the view that "many developing and transition countries have fairly simple tax laws."[11]

As regards (b), William Pitt introduced income tax in the UK as a temporary measure to help finance the Napoleonic war.[12] Henry Addington reintroduced income tax in 1803.[13] Sir Robert Peel last introduced income tax in 1842 as a three-year temporary measure, but income tax has been with the UK ever since.[14] Meanwhile, PIT was introduced in Thailand in 1938.

The difference in the development of the UK's income tax and Thailand's PIT has caused differences in the main components of both systems. For example, the UK tax bands and personal allowances have been adjusted for inflation every year; meanwhile, there are no such adjustments under Thai law. UK law has principally applied a deduction of actual expenses from assessable income to determine taxable income; meanwhile, Thai law has applied a standard deduction in addition to a deduction of actual expenses. The UK has adopted the system of individual/independent taxation. Meanwhile, Thailand has adopted the joint-taxation system. These differences are believed to have different impacts on equity and efficiency.

Additionally, the difference in the development of the PIT systems of both countries has caused differences in the legislative process, judicial interpretation, anti-avoidance measures and the method of tax collection. For example, the Thai Parliament can enact any tax law subject to a constitution, whereas the enactment of UK tax laws is not subject to a constitution. As Morse and Williams note,

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[10] Victor Thuronyi, Comparative Tax Law (The Hague: Kluwer Law International, 2003), 17.
[11] ibid.p.19
[12] Author not identified, CCH Tax Handbook 2003-04 (Surrey: CCH, 2003), 504.
[13] ibid.p.504
[14] ibid.p.150

"We don't have a constitution. In tax matters that is most important. Constitutions almost always contain rules limiting aspects of the right to impose taxes. We have no such rules."[15]

Besides, the UK has adopted the system of consolidation; meanwhile, Thailand has adopted the system of codification. The UK Parliament is required to pass an annual Finance Act in relation to taxation; meanwhile, the Thai Parliament is not required to pass such Act. The UK courts are increasingly adopting a purposive approach to interpreting tax laws; meanwhile, the Thai courts have still stuck to a strict interpretation. The UK government has recently introduced rules governing disclosure of tax-avoidance schemes; meanwhile, there are no such rules in Thailand. In the UK, most people whose income tax is withheld at source through the PAYE system are not required to file end-of-year tax returns. Meanwhile, Thai law still requires most individuals to file end-of-year tax returns despite withholding at source.

The above examples of dissimilarity are believed to have different impacts on efficiency in tax legislation and administration in both countries, affecting efficiency and equity.

6. Underlying concept of equity

6.1 Income inequality, concept and methods of income redistribution

The initial distribution of income takes place when people get involved in economic activities under the market system. In the market system, individuals initially derive income from two main sources, i.e. income from work and income from property. Income from these sources is known as 'original income' or 'market income.'

Barna remarked in 1937 that "in most modern communities incomes are distributed in a very unequal manner; there are rich and there are poor, but while the number of the rich is few, the poor are many."[16] Even if this remark was made more than sixty years ago, it has been found that there are still rich and poor and a wide

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[15] Geoffrey Morse and David Williams, Davies: Principles of Tax Law, 5th ed. (London: Sweet&Maxwell, 2004), 37.

[16] Tibor Barna, Redistribution of Incomes through Public Finance in 1937 (Oxford: Clarendon Press, 1945), 5.

income gap between them in the UK and Thailand.[17] In other words, the distribution of income under the market system in the UK and Thailand is unequal, leading to income inequality and a wide income gap.

Due to income inequality, income redistribution may be considered to be required to generate a more equal distribution of income. Cowell supports the view that "...a very successful redistribution policy will have diminished rather than completely eliminated real income differences."[18] This is because the elimination of differences in market income implies "destroying the advantages of efficiency and freedom which the market offers."[19]

Smolensky points out that "no government now simply accepts the distribution of income as generated by markets [;] on the contrary, all governments now actively seek to affect income distribution."[20] Governments can improve the existing distribution of income to achieve income redistribution by reallocating resource in the economy.

A government may have a mandate to redistribute resources from the better-off to the worse-off. Narrowly speaking, money is compulsorily taken by the government from the rich and given to the poor. This is regarded as the basic concept of income redistribution or "vertical redistribution"[21], which is widely recognized as the proper way to redistribute income.[22]

Methods of income redistribution include taxation and public expenditure, subsidies and price controls, legislation and regulation. Among these methods, the

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[17] The selected statistics and the causes of income inequality in **Appendix I to Chapter One** will prove this point.

[18] F.A. Cowell, "Redistribution of Income and Wealth", The New Palgrave A Dictionary of Economics, John Eatwell, Murray Milgate and Peter Newman, eds. (London: Macmillan Press, 1987), 111.

[19] Cedric Sandford, Social Economics (London: Heinemann Educational Books, 1977), 123.

[20] Eugene Smolensky, Encycopedia of Economics, Douglas Greenwald, ed. (London: McGraw-Hill Book Company, 1982), 487.

[21] There is another advanced concept of income redistribution, which will be found in **Appendix II to Chapter One.**

[22] Barna, op.cit.(note16), pp.5-6; Joseph E. Stiglitz, Economics of the Public Sector (New York: W.W Norton & Company, 1986), 31; D.A. Collard, "Limits to Redistribution: An Overview", Income Redistribution: the Limits to Redistribution (Bristol: John Wright & Sons., 1980), 1; Martin Schnitzer, Income Distribution: A Comparative Study of the United States, Sweden, West Germany, East Germany, the United Kingdom, and Japan (New York: Praeger Publisher, 1974), 192-193; The Commission on Taxation and Citizenship, Paying for Progress: A New Politics of Tax for Public Spending (London: Fabian Society, 2000), 231; and Adrian L. Webb and Jack E.B. Sieve, Income Redistribution and The Welfare State (London: G.Bell & Sons, 1971), 8.

combined system of taxation and public expenditure is accepted as a "better" or more "acceptable distribution."[23] Tax and expenditure measures are known as 'the public-finance system.' Under this system, a government provides the poor with more state benefits through public expenditure financed by taxes on the rich.[24] Redistribution through the public-finance system is therefore consistent with the basic concept of redistribution.

6.2 Use of taxation to achieve redistribution.[25]

Brown and Jackson remark that "because [the government] has the resources of compulsory taxation it is better placed to redistribute incomes on a large scale."[26] Their view is correct because:

(a) the government can use tax revenue to fund public expenditure in favour of the poor; and

(b) a tax system with a progressive structure can reduce income inequality.

Financing for public expenditure

Taxation is accepted as the most efficient way to raise revenue to finance public spending.[27] However, the degree to which revenue can be raised through taxation is determined by (a) efficiency of taxation, and (b) the level of desired government expenditure.

Factor (a) will be examined in section 7. Relating to factor (b), it is asserted, "the level of taxation and public expenditure need to be determined together."[28] Given this, the government must receive sufficient tax revenue to pay for state benefits to achieve the redistributive purpose.

Progressive taxation for redistribution[29]

The basic concept of progressive taxation ("the concept of progressivity") is that a higher proportion of income is taken in tax when a taxpayer's income

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[23] Chalongphob Sussangkarn et al., The Tax Structure in Thailand and Its Distribution Implications (Bangkok: Thailand Development Research Institute Foundation, 1988), 42.
[24] Schnitzer, op.cit.(note22), p.10
[25] Discussion on legitimacy of government in taxation will be found in **Appendix III to Chapter One**.
[26] Brown and Jackson, op.cit.(note2), p.38
[27] James and Nobes, op.cit.(note5), p.8
[28] The Commission on Taxation and Citizenship, op.cit.(note22), p.368

increases. This concept is widely recognized by many scholars.[30] The effect of progressive taxation is that it can "smooth out the dispersion of incomes after tax and works towards a more equal distribution."[31]

Direct taxes (except for local taxes)[32] are found to be progressive. PIT is usually a progressive tax because it has a progressive structure of its own. As one notes, "because of the progressive nature of the income tax system, the amount of tax payable increases both in cash terms and as a proportion of income as income increases."[33]

6.3 Equity of income redistribution

The progressive structure of PIT has stemmed from its equity. As James and Nobes note, "[the] decision about the redistribution of income via progressive taxation…..[is] based on widely held feeling that this is equitable."[34] Here, I will examine (a) what is equity and how it is approached; and (b) what are the requirements for the equity of income redistribution.

What is equity?

Equity is a subjective concept with no absolute definition, and it cannot be derived from an economist's judgement.[35] Additionally, "there is much disagreement about what equity means and how the equity of a tax system can be judged."[36]

Despite being a subjective concept and there being disagreement about the meaning, equity in this context can be defined as the fair share/distribution of the tax burden among individuals.[37] Nevertheless, the Musgraves point out that "there is no such agreement about how the term 'fair share' should be defined."[38] As shown

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[29] Discussion on progressive taxation versus public expenditure will be found in **Appendix IV to Chapter One.**

[30] For example, Hugh Dalton, Principles of Public Finance, 4th ed. (London: Routledge & Kegan Paul, 1966), 93; Sandford, op.cit.(note19), p.146; and Schnitzer, op.cit.(note22), p.7

[31] Paul Marshall, "Welfare: Inequality and Poverty", Understanding The UK Economy, 3rd ed., Peter Curwen, ed. (Hampshire: Macmillan Press, 1994), 360.

[32] Tim Harris, "The effects of taxes and benefits on household income, 1998-99", Economic Trends/No.557/April 2000 (London: The Stationery Office, 2000), 45.

[33] The Office for National Statistics ('**ONS**'), Social Trends/No 31/2001Edition, Jil Matheson and Carol Summerfield, eds., (London: The Stationery Office, 2001), 102.

[34] James and Nobes, op.cit.(note5), p.78

[35] David N.Hyman, Public Finance, 4th ed. (Fort Worth: The Dryden Press, 1993), 359.

[36] N.Gregory Mankiw, Principles of Economics (Fort Wort: The Dryden Press, 1998), 10.

[37] ibid.p.257

[38] The Musgraves, op.cit.(note 5) p.227

below, equity or the fair share/distribution of the tax burden should require people to make different contributions to the cost of government according to their circumstances.

Public expenditure is mostly funded by compulsory taxation. However, people are in different positions, have different capabilities and opportunities, and take different public benefits. On this basis, people should make different contributions to the cost of government, so that "those who have benefited more from the distribution of income and wealth in the market have a duty to contribute more in return."[39]

The requirement for different contributions has two implications. Firstly, people in different circumstances should bear different tax burdens ("vertical equity").[40] Secondly, people in equal circumstances should bear equal tax burdens. ("horizontal equity").[41]Given this, equity affects the tax treatment of people in similar and dissimilar circumstances.[42]

Approaches to equity

Equity under the definition 'similar and dissimilar tax treatment' can be approached by either the benefit principle or the ability-to-pay principle. According to the benefit principle, equity is approached if individuals or groups pay taxes in accordance with state benefits received. Meanwhile, under the ability-to-pay principle, equity is approached if each individual pays tax according to his/her ability to pay.[43]

The question arises as to which principle is the better approach to equity. The advantages and disadvantages of both principles will be considered to answer this question.

The benefit principle can apply to similar and dissimilar tax treatment. People who receive the same state benefits will pay the same taxes. Individuals who receive more state benefits will be taxed more than those who receive less. Despite this

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[39] The Commission on Taxation and Citizenship, op.cit.(note22), p.94
[40] A.R. Prest, Public Finance in Theory and Practice, 3rd ed. (London: Weidenfeld and Nicolson, 1967), 114.
[41] ibid.p.114
[42] ibid.p.114
[43] H.A.Silverman, Taxation its Incidence and Effects (London: Macmillan, 1931), 69.

advantage, the benefit principle is unlikely to be the better approach to equity. Its disadvantages are: -

(a) the nature of tax and the nature of public goods and services,

(b) difficulties in calculation of the cost of goods and services provided and benefits received, and

(c) the impact on income redistribution.

As regards (a), the benefit principle treats tax as a direct payment in return for goods and services received.[44] This is not true in practice. Firstly, "a tax is not a price,"[45] but it is "a compulsory exaction"[46] or "a payment in return for which no direct and specific quid pro quo is rendered to the payer."[47] Secondly, some goods and services which are communal cannot be charged in a similar manner as those supplied in market places.[48]

As regards (b), it is possible to calculate the cost of some goods and services, but others with a common nature are impossible to trace. Additionally, beneficiaries of public goods and services are unidentified. Many scholars support this argument.[49]

As regards (c), the Musgraves remark that the benefit principle "has the disadvantage of excluding redistributional considerations."[50] This remark may be correct. Firstly, the rich and the poor might pay equal taxes if they received the same state benefits. Secondly, the poor might receive more from certain benefits in kind, and therefore they could pay more taxes than the rich for such benefits.

Regarding the advantage of the ability-to-pay principle, this principle can apply to similar or dissimilar tax treatment, i.e. people with equal ability to pay will pay the same tax[51]; meanwhile, people with different ability to pay will pay different

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[44] ibid.p.10
[45] ibid.p.66
[46] ibid.p.66
[47] Dalton, op.cit.(note30), p.61
[48] Prest, op.cit.(note40), p.118
[49] For example, Silverman, op.cit.(note43), p.66; and Otto Eckstein, Public Finance, 2nd ed. (New Jersey: Prentice-Hall, 1967), 60.
[50] The Musgraves, op.cit.(note5), p.245
[51] Morse and Williams, op.cit.(note15), p.6

tax.[52] Accordingly, people with greater taxable capacity will pay more tax than those with less.

The ability-to-pay principle is likely to be the better approach to equity. However, there are questions in connection with the ability-to-pay principle, i.e. how to measure and how to know whether people have the same or different taxable capacity. As Whittington notes, "this principle has the problem of defining precisely who are equals; for example, two taxpayers with equal incomes may have different family responsibilities."[53]

As regards the measurement of taxable capacity, income has widely been accepted as the basis for the measure of taxable capacity.[54] On this basis, higher-income earners have greater taxable capacity, while lower-income earners have less.

Nevertheless, "individuals with the same gross income will not necessarily pay the same total level of tax."[55] Similarly, "equal income may not imply equal ability to pay if taxpayers are in otherwise different positions."[56] This point relates to the question of how we exactly know that people have the same or different taxable capacity.

Besides income, factors that can determine taxable capacity include: -

(a) personal character (e.g. age and disability),

(b) personal circumstances (e.g. marital status and family responsibility/ expenditure), and

(c) the expenses in obtaining an income.

Requirements for the equity of income redistribution

Despite certain difficulties with the ability-to-pay principle (which could be resolved), equity under the ability-to-pay principle is consistent with the basic concept of redistribution. However, the equity of income redistribution requires a progressive structure additional to the ability-to-pay principle.

The objective of redistribution is to reduce income inequality by reallocating resources from the rich to the poor. To properly satisfy this objective, those with

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[52] Eckstein, op.cit.(note49), p.60

[53] Geoffrey Whittington, "The Direct Tax System", Taxation and Social Policy, Cedric Sandford, Chris Pond and Robert Walker, eds. (London: Heinemann Educational Books, 1980), 156.

[54] Nicholas Kaldor, An Expenditure Tax, 4th ed. (London: Unwin University Books, 1965), 23.

[55] The Commission on Taxation and Citizenship, op.cit.(note22), p.69

[56] The Musgraves, op.cit.(note5), p.344

greater taxable capacity are required to pay not only a higher amount but also a higher proportion of their income in tax than those with less taxable capacity.

To force those with greater taxable capacity to pay a higher proportion of their income in tax than those with less taxable capacity, a progressive structure is therefore required in addition to the ability-to-pay principle. The following example is likely to support this argument.

> "As between two men, one with £5,000 a year and one with £500 a year, the tax burden could not be said to be equitably distributed between the two unless the first man were called upon to pay a proportionately higher sum than the second."[57]

From the above, to achieve the equity of income redistribution, the main components of PIT are required:

(a) to take a higher amount and a higher proportion of income in tax from people with greater taxable capacity,

(b) to take a lower amount and a lower proportion of income in tax from people with less taxable capacity, and

(c) not to take a different amount and a different proportion of income in tax from people with the same taxable capacity.

7. Underlying concept of efficiency

7.1 Characteristics of economic efficiency of taxation

There are two parties involved in the taxing process, i.e. tax-gatherers and taxpayers. In this process, there must be costs incurred by both sides, i.e. administrative costs and compliance costs.

As regards **administrative costs**, such costs must be low in relation to the revenue that they generate to raise appropriate revenue. Meanwhile, **compliance costs** should also be as low as possible. Compliance costs are other burdens to taxpayers additional to the amount of tax they pay. Greater burdens to taxpayers due to high compliance costs probably lead to (a) considerable reduction in taxpayers' disposable income and (b) unwillingness to pay tax.

Regarding (a), disposable income is supposed to be saved and invested. The less disposable income taxpayers have, the less they can save and invest. Taxpayers' abilities to increase income from saving and investment are therefore prevented by having a lower disposable income. Consequently, revenue from taxation on yields from saving and investment declines.

Concerning (b), revenue from taxation would decline if taxpayers were unwilling to pay tax. Increased burdens to taxpayers due to high compliance costs mean greater loss to them. This loss possibly may generate "an anti-tax mentality and an antipathy to the tax system which in turn generates avoidance and more particularly, evasion."[58]

Besides low costs, taxation must cause **minimum distortionary/disincentive effects** on economic activities. The disincentive effect obstructs the creation of income by taxpayers. Consequently, the government probably receives less revenue from income taxation through decline in the tax base. The disincentive effect should therefore be minimized. In the economics literature, the disincentive effect is the excess burden or **deadweight loss**[59]which should be eliminated.[60]

Altogether, low administrative and compliance costs and minimum deadweight loss will result in greater tax revenue. So, low costs and minimum loss in the taxing process are the characteristics of economic efficiency of taxation.

7.2 Low administrative costs

There would be lower administrative costs if some factors of high administrative costs were removed. Complex legislation and tax avoidance and evasion are primary factors influencing an increase in administrative costs. This is because complex legislation is onerous for tax-gatherers to administer.

It appears that tax avoidance and evasion result in a large loss in tax revenue. For example, about 47% of tax revenue in Thailand in 1986 was lost through

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[57] Kaldor, op.cit.(note54), p.26

[58] Cedric Sandford, "Tax Compliance Costs, Evasion and Avoidance", Income Redistribution: the Limits to Redistribution, David Collard, Richard Lecomber and Martin Slater, eds. (Bristol: John Wright & Sons, 1980), 155.

[59] Mankiw, op.cit.(note36), p.244

[60] J.A. Kay and M.A.King, The British Tax System, 5th ed. (Oxford: Oxford University Press, 1990), 18.

corruption and tax evasion.[61] Also, there is evidence that a credible figure of tax evasion was between 2 and 5 % of GDP between the period 1981-1993 in the UK.[62] A reduction in tax avoidance and evasion is therefore necessary. In achieving this, an increase in administrative costs is unavoidable to fund extra personnel and materials to prevent and detect tax avoidance and evasion.

The tax system should therefore lessen the primary causes of high administrative costs. First, tax legislation should be made simple and uncomplicated. It will then be easy for tax-gatherers to understand and administer. As tax loopholes may still be found in complex legislation, simplicity is likely to close such loopholes as well. Consequently, extra government resources may not be needed to deal with simpler legislation or to pass special provisions to close tax loopholes.

Secondly, a reduction in incentives for taxpayers to avoid and evade tax is believed to help minimize tax avoidance and evasion. Additionally, the system of tax administration must be regularly modernized to prevent new methods of tax avoidance and evasion. When tax avoidance and evasion decline, the government may not need extra resources to prevent and detect avoidance and evasion.

7.3 Low compliance costs

There would be lower compliance costs if some factors of high compliance costs were eliminated. As with administrative costs, the primary factors of high compliance costs are (a) complex legislation and (b) tax avoidance and evasion.

Complex legislation increases compliance costs because it is hard for taxpayers to understand and comply with. They may then have to spend extra time and money in dealing with complex legislation by themselves, taking more advice from professionals etc.

High compliance costs resulting from complex rules reduce taxpayers' disposable income and may further result in their unwillingness to pay tax. Another possible cause of taxpayers' unwillingness to pay tax is the supposition of some taxpayers that others can take advantage of complex legislation to search for

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[61] Anwar Shah and John Whalley, An Alternative View of Tax Incidence Analysis for Developing Countries (Washington, D.C.: The World Bank, 1990), 51.
[62] Andrew Dilnot and Gary Stears, "The United Kingdom", The Tax System in Industrialized Countries, Ken Messere, ed., (New York: Oxford University Press, 1998), 369.

loopholes to minimize their tax burdens.[63] Those who are unwilling to pay tax may either search for tax loopholes (as they suppose others do) or find illegal ways to escape tax.

Tax avoidance and evasion may result from other causes related to reducing tax liability. Tax avoidance and evasion increase compliance costs to non-avoiders and non-evaders. This is because they may spend extra time and money in complying with complex anti-avoidance rules. Additionally, tax avoidance and evasion generate costs to tax-avoiders and evaders ("non-compliance costs"). It has been discovered that considerable resources are used by taxpayers in avoidance and evasion schemes in some countries.[64]

Increased compliance and non-compliance costs as a result of tax avoidance and evasion are not useful to the taxing process, as they lead to a considerable loss of tax revenue.

The tax system should therefore lessen the primary causes of high compliance costs (and non-compliance costs). In doing so, measures recommended for reducing high administrative costs can be applied, i.e. (a) employing simple tax legislation, and (b) reducing tax avoidance and evasion.

As regards (a), it will be easy for taxpayers to understand and comply with simple legislation. Furthermore, simplicity would reduce loopholes for tax avoidance. Consequently, taxpayers need not spend extra time and money in dealing with simpler legislation and fewer anti-avoidance rules.

As regards (b), a reduction in incentives to avoid and evade tax as well as modernization of the administrative system to prevent new avoidance and evasion schemes could minimize tax avoidance and evasion. This will help remove non-compliance costs from the taxing process. Additionally, when tax avoidance and evasion decline, there will be fewer anti-avoidance rules for taxpayers to comply with.

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[63] Joel Slemrod and Jon Bakija, Taxing Ourselves (London: The MIT Press, 1996), 134.

7.4 Minimum deadweight loss

It has been found that "all economic activities have costs and benefits associated with them"[65], and "people's economic behavior/decisions may change when the costs or benefits change; [that] is, people respond to incentives [in relation to costs and benefits]."[66]

Once a tax is imposed on any economic activity, the benefit received from such activity decreases. Consequently, the tax possibly reduces the incentive to engage in a taxed activity, or it may provide the disincentive to do a taxed activity. Similarly, the tax may encourage a person to engage in untaxed or lightly taxed activities instead. It seems that people engage in economic activities "according to the tax incentive rather than the true costs and benefits."[67]

The distortion of the tax in incentives is not limited to work effort. The distortion extends to other economic activities, e.g. saving and investment. Many scholars support this point.[68] Therefore, the distortionary/disincentive effect possibly prevents earning opportunities in various forms, such as doing extra work, saving more or investing. This results in revenue loss from taxation on income from extra work, higher levels of saving or investment. This is regarded as deadweight loss.

To minimize the distortionary/disincentive effect, the tax should be neutral to, or interfere as little as possible with, taxpayers' economic decisions. The neutrality approach has been applied in tax reforms since the mid 1980s.[69] Many writers agree that the neutrality approach means avoidance of distortions in incentives or in economic decisions. [70] Nevertheless, real neutrality hardly happens in the real world for two reasons:

(a) "people do take tax considerations into account in their personal and business decisions"[71]; and

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[64] Wayne Thirsk, Lessons of Tax Reform: An Overview (Washington, D.C.: The World Bank, 1991), 21.

[65] Kath Nightingale, Taxation Theory and Practice, 3rd ed. (Essex: Pearson Education, 2000), 8.

[66] Mankiw, op.cit.(note36), p.7

[67] ibid.p.244

[68] For example, Mankiw, op.cit.(note36), p.163; and Joseph E. Stiglitz, Economics of the Public Sector, 2nd ed. (New York: W.W. Norton, 1988), 391.

[69] Nightingale, op.cit.(note65), p.50

[70] For example, OECD, Personal Income Tax Systems: Under Changing Economic Conditions (Paris: OECD, 1986), 42; and Nightingale, op.cit.(note65), p.8

[71] Eckstein, op.cit.(note49), p.77

(b) as a result of progressive taxation, the larger a taxpayer's income, the greater the extent of the distortion of a progressive tax in incentives.

Therefore, it is hard completely to avoid the distortion of the tax in incentives. As Gelardi asserts, the principle of neutrality "is often violated, resulting in tax laws that distort taxpayers' behavior."[72] Minimal distortion of the tax in taxpayers' economic behavior/decisions should therefore replace real neutrality, which would reduce the distortionary/disincentive effect and deadweight loss.

8. Restriction to PIT

As noted earlier, this research aims to seek optimal taxation to promote equity by reducing income inequality between people in the same society (in addition to promoting efficiency). Therefore, it has to find out a tax system which can make the distribution of income more equal between individuals. Likewise, this research has to search for a tax system which can cause the transfer of income from the better off to the worse off to reduce income inequality to a desired extent. It is argued that "[PIT] will reduce economic inequality or check the growth of inequality."[73] Based on this argument, this research is confined to PIT.

The question arises why PIT is a better means to reduce income inequality than other direct taxes, particularly corporation tax ('CT') and capital gains tax ('CGT'). **As compared between PIT and CT, the former is better than the latter for the following reasons.**

First, PIT is a tax on the income of *individuals*; meanwhile, CT is a tax on the profits (i.e. income and chargeable gains) of *companies*.[74] Therefore, PIT is more relevant to the distribution of income between individuals. Additionally, tax incidence falls directly on individuals who are required to pay PIT; consequently, it is difficult for taxpayers to shift the tax burden to someone else.

Secondly, a *progressive* tax is a more powerful device for reducing income inequality than a *proportional* tax. As noted earlier, PIT which has a *progressive* structure requires a *higher* proportion of income to be paid in tax as income rises.

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[72] Alexander M.G. Gelardi, "The Influence of Tax Law Changes on the Timing of Marriages: A Two-Country Analysis", National Tax Journal, Vol. XLIX (1996), 17.

[73] Richard Goode, The Individual Income Tax (Washington, D.C.: The Brookings Institution, 1966), 260.

Consequently, PIT can make richer people pay not only a higher amount but also a larger proportion of their income in tax than poorer people.

Meanwhile, a *proportional* tax (e.g. CT under Thai law) requires a *constant* proportion of income to be taken in tax as income increases.[75] In other words, although richer people pay more in tax than poorer people, richer people and poorer people pay the same proportion of income in tax. Consequently, a *proportional* tax cannot achieve a more equal distribution of income in the same way as a *progressive* tax does.[76]

Thirdly, income tax is the largest source of revenue for the UK government[77] (for example, "receipts of income tax in 2003-04 amounted to 73% of the total sum raised by direct taxes, [CT] 18% and CGT 1.4%.")[78] Therefore, income tax is the most important source of the government's revenue to fund public expenditure in favor of the poor. Similarly, it is the greatest help for the government to transfer incomes from the rich and provide state benefits for the poor to reduce income inequality in the UK.

As compared between PIT and CGT, the former is a better tool for reducing income inequality than the latter for the following reasons.

First, CGT relates to the distribution of wealth rather than the distribution of income. This is because CGT is a tax on gains accruing on disposals of assets by an

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[74] CCH Tax Handbook, op.cit.(note12), p.513 and p.2007

[75] Under Thai law, CT is charged at the *constant* rate of 30% regardless of the variation of the profits of the company.

However, the UK law is different from the Thai law. Under UK law, "the standard rate of [CT] in 2005-06 is 30% with a reduced rate of 19% on profits under 300,000 pounds [;] [for] firms with profits between 300,000 pounds and 1,500,000 pounds, a system of relief operates, such that an effective marginal rate of 32.75% is levied on profits in excess of 300,000 pounds [;] [this] acts to increase tax rate gradually until it reaches 30%." As from April 2006, for all firms with profits up to 300,000 pounds, a single 19% rate will apply.

(Stuart Adam and James Browne, A Survey of The UK Tax System (updated January 2006), http:www.ifs.org.uk/bns/bn09.pdf, 19.)

[76] A *regressive* tax (e.g. VAT, customs duties and excise duties) is the worst tax system for reducing income inequality. This is because under regressive taxation, the proportion of income paid in tax is lower for the rich, but higher for the poor. (ONS, op.cit.(note33), p.102) This is because the expenditure of some low income households is higher than their current incomes. (Harris, op.cit.(note32),p.45)

[77] In Thailand, the four largest sources of revenue are excise taxes, VAT, CT and PIT respectively.

[78] Emma Chamberlain, et al., Revenue Law – Principles and Practice, 23rd ed. (West Sussex: Tottel Publishing, 2005), 6.

individual.[79] Similarly, CGT is a tax on "the gain represented by the difference between the price at which an item was acquired and the price at which it is sold."[80] Therefore, CGT is a tax on an increase in an individual's wealth through the sale of assets.

Secondly, "income tax is a tax on profits or gains of an income nature" [81]; meanwhile, CGT is "a tax on gains of a capital nature."[82] Despite this, "most forms of capital gains have much the same characteristics as income."[83] Nevertheless, CGT is not a powerful device for reducing inequality because "there are a large number of exemptions and reliefs applying to CGT."[84]

Thirdly, CGT is a progressive tax in the UK, namely:

> "Taxable capital gains are in effect subject to income tax as if they were savings income: treated as the top slice of income, capital gains are taxed at 10% below the starting-rate limit, 20% between the starting- and basic-rate limits, and 40% above the basic-rate limit."[85]

However, in practice, CGT is a proportional tax, i.e. "most capital gains are subject to 40% tax."[86] Despite this, CGT cannot considerably help transfer resources from the rich to fund public expenditure because as we saw, receipts of CGT are a small proportion of the total sum raised by direct taxes. It is noted that "its fiscal significant is trivial compared with [income tax]."[87]

9. What is covered by PIT?

As PIT raises revenue from individuals' economic activities, income which is charged to PIT covers not only earned income but also unearned income.

Under Thai law, PIT is charged on money income which covers earned income (such as income from employment, income from self-employment, and income from business) and unearned income (such as income from intangible

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[79] Author not identified, Simon's Direct Tax Service: Binder 2 (London: Lexis Nexis Butterworths, 1995), 1103.
[80] Morse and Williams, op.cit.(note15), p.12
[81] CCH Tax Handbook, op.cit.(note12), p.513
[82] ibid.p.513
[83] James and Nobes, op.cit.(note5), p.166
[84] CCH Tax Handbook, op.cit.(note 12), p.3009
[85] Adam and Browne, op.cit.(note75), p.16
[86] ibid.p.16

properties, and interest, dividends and other income from investments). PIT is also charged on all types of item which are an accretion to individuals' economic power and equivalent to money income (such as any other benefits received which are ascertainable in terms of money). Additionally, capital gains are regarded as being equivalent to income, they are subject to PIT in Thailand. For example, gains from sales of immovable property are charged to PIT.

Under UK law, income tax is charged on employment income (such as any salary, wages and fee), pension income (such as pensions and annuities), social security income (such as bereavement allowance, carer's allowance and income support), trading income (such as the profits of a trade, profession and vocation), property income (such as the profits of a UK property business), savings and investment income (such as interest, dividends and other distributions from UK resident companies), and certain miscellaneous income (such as receipts from intellectual property).

Although PIT or income tax is charged on individuals' income, there are items of income that are exempted from PIT (under both Thai and UK laws). Because of this, "income tax is not a tax on all income."[88]

More detailed discussion on income subject to PIT and non-taxable income will be given in **Chapter Three.**

10. Possible conflict caused by the components of PIT

Because of its progressive nature, PIT can make the distribution of income *after* tax more equal between individuals. A progressive structure is implemented by tax reliefs (particularly personal tax allowances) and/or the progressive rate structure.

Furthermore, PIT is imposed not only on income but also on gains of a capital nature, which reinforces a reduction in economic inequality. As Morse and Williams note that under the UK law[89], "there are some charges to income tax that are imposed

[87] Morse and Williams, op.cit.(note15), p.12
[88] ibid.p.11
[89] Under Thai law, capital gains are charged to PIT (as noted above).

on receipts that are not income tax receipts, but rather capital receipts."[90] For example, "premiums received on leasing land."[91]

As noted above, there are items of income that are exempted from PIT. In addition to tax exemptions and tax allowances, there are other types of tax reliefs brought into the PIT system, including tax credits and tax deductions. Tax reliefs can be designed and used to discharge or reduce the tax burden on the poor, thereby reducing income inequality.

Many tax provisions are used to embrace and bring the components of PIT (such as tax rates, many types of income, and tax reliefs) into effect to achieve the equity purpose. However, these provisions cause legal complexity. The Musgraves support the view that "equity considerations may call for a more complex law"[92], and "equity may require administrative complexity."[93]

However, as discussed earlier, complex legislation increase administrative and compliance costs. Therefore, it may be said that PIT covers the progressive nature of taxation, income and capital receipts, and a tax concession which promotes equity while embracing many complex tax provisions which discourage efficiency.

Additionally, PIT may distort people's economic decisions on work, saving and investment since incomes from these activities are charged to PIT at progressive rates. People may therefore avoid paying higher tax on higher income by choosing to work less, save less, and invest less. Consequently, the government probably receives less revenue from income taxation.

Tax reliefs may also distort people' decisions on resource allocation to tax-preferred activities. This is because tax reliefs can be used for several purposes other than reducing the tax burden on the poor, namely they can be used to encourage particular economic activities.

Therefore, it may also be said that PIT covers taxation of income and a tax concession while having an effect on the distribution of income *before* tax by distorting people's economic behavior and resource allocation which discourage efficiency.

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[90] Morse and Williams, op.cit.(note15), p.11
[91] ibid.p.11
[92] The Musgraves, op.cit.(note5), p.291
[93] ibid.p.225

High marginal rates of PIT promote equity to a desired extent. However, "because of high rates of tax, evasion and avoidance become very much more rewarding pursuits."[94] Besides, if an individual is a tax unit, he/she may reduce income tax liability by transfer his/her investment income to his/her spouse in order to reduce taxable income and avoid high marginal tax rates. Tax reliefs also provide incentives for tax avoidance and evasion because they discharge or reduce tax liability. For example, "tax expenditures [or non-structural reliefs] in favour of activities deemed worthy of encouragement, lead to the creation of tax-inspired shelters."[95]

As noted earlier, tax avoidance and evasion erode tax revenues, generate high administrative and compliance costs. Finally, it may be said that PIT covers progressive income taxation on individuals and a tax concession while encouraging tax avoidance and evasion which discourage efficiency.

10. Originality of this research

Striking the balance between equity and efficiency is widely accepted as a proper means to reduce the conflict, which is known as 'optimal taxation'. Most optimal taxation literature so far has been written in terms of economics. Nevertheless, this has a limited use in tax policy. According to Heady,

> "It is an interest in tax policy that has led a number of economists to undertake research on optimal taxation, and so one might expect the link between the research and the policy-making to be clear. However, the level of abstraction of much of the research, together with the extensive use of (sometimes difficult) mathematics, has caused many policy-orientated people to discount its practical value. It is dismissed as being 'academic', with little or no practical value."[96]

Besides, James and Nobes have taken note of criticism by Atkinson and Stiglitz as follows:

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[94] James and Nobes, op.cit.(note5), p.154

[95] Graeme Cooper, "Conflicts, Challenges and Choices – The Rule of Law and Anti-Avoidance Rules", Tax Avoidance and the Rule of Law, Grames S. Cooper, ed., (Amsterdam: IBFD Publications BV, 1997), 43.

[96] Christopher Heady, "Optimal Taxation as a Guide to Tax Policy", Fiscal Studies, Vol. 14, No. 1(1993), 15.

"[The] analysis [on optimal taxation] does not lead to unambiguous policy conclusions and that the results depend on economic relationships about which there is little empirical evidence."[97]

Additionally, most economics literature on optimal income taxation has focused only on the tax rate.[98] Some deal only with the tax base.[99] Therefore, other important components of PIT are omitted that could strike a balance between equity and efficiency. This is supported by criticism referred to in James and Nobes as follows:

"The work undertaken to date on optimal taxation has attracted some criticism. ...... The criticism that the analysis has neglected several important aspects such as horizontal equity, evasion, administration and taxpayer preferences between different taxes is largely accurate. However, this does not, of course, prevent such aspects from being incorporated into future work."[100]

Owing to certain constraints in using economics literature, research in *law* is another possible alternative way to seek a balance between equity and efficiency.

First, the study of a good tax system is the subject-matter not only of economics but also of law.

Secondly, the conflict between equity and efficiency results from legislative process as well as tax policy because tax policy cannot be applied without the enactment and enforcement of tax laws.

Thirdly, research in *law* need not require mathematical discussion. This argument is supported by such criticism referred to in James and Nobes that:

"....the conclusions of optimal tax analysis have been reached by intuitive argument, without the need for extensive mathematical analysis."[101]

Fourthly, research in *law* is likely to cover more extensive areas that lead to conflict between equity and efficiency. There is a possibility that the conflict will

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[97] James and Nobes, op.cit.(note5), p.72

[98] For example, A.B. Atkinson, Public Economics in Action: The Basic Income/Flat Tax Proposal (New York: Oxford University Press, 1995), 47-61; IFS, The Structure and Reform of Direct Taxation: Report of a Committee chaired by Professor J.E.Meade (London: George Allen & Unwin, 1978), 12; Alm, op.cit.(note2), pp.129-130; and Heady, op.cit.(note96), pp.24-30

[99] For example, Alm, op.cit.(note2), pp.129-130

[100] James and Nobes, op.cit.(note5), p.71

[101] ibid.pp.71-72

extend beyond matters of the tax rate and the tax base. Besides, the conflict may result from the different objectives of using joint or independent taxation of spouses, and from legal complexity or simplicity. The tax rate, tax base, and tax unit are related to tax legislation, tax administration and compliance as well as tax avoidance and evasion. These tax matters are all concerned with the legal system of PIT. Therefore, dealing with more extensive areas by research in *law* is more likely to strike the balance between equity and efficiency.

This research involves research into the components of substantive PIT *law* in Thailand and the UK[102] to establish *optimal tax structures* to strike *a balance between equity and efficiency*. Thus, it offers a *novel/original* way to reduce the conflict between equity and efficiency. To do so, the main components of substantive PIT law of both countries will first be **examined and compared** to find out their current state and how they operate. Thereafter, **legal solutions** will be proposed to establish optimal tax structures, if the operation of any component has been found to lead to the conflict between both criteria.

Examination and comparison

The main components of substantive PIT law include tax rates, the tax base, and the tax treatment of spouses. These components under Thai and UK laws will be examined and compared. Such examination and comparison aim to search for the following: -

(a) to what extent these components work under equity and efficiency requirements; and

(b) to what extent these components lead to conflict between equity and efficiency.

As "tax law is about words"[103], words and expressions in relevant taxing provisions will be clarified in carrying out the examination and comparison. Perception of the meaning and application of substantive PIT law (together with the study and analysis of the underlying tax policy, which will be proposed in section 12) will help make the examination and comparison to achieve the above purposes.

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[102] A comparison between Thai and UK PIT law also offers originality.

[103] Morse and Williams, op.cit.(note15), p.21

Solutions

Legal solutions will be proposed to strike a balance between equity and efficiency if the above examination and comparison discovers that any component of substantive PIT law leads to conflict between equity and efficiency. The proposed legal solutions can be made via possible reform/changes in any questionable component of substantive PIT law.

The above changes/reform will establish the optimal components of substantive PIT law, i.e. optimal statutory tax rates, an optimal tax base, and the optimal tax treatment of spouses. These optimal tax structures or the proposed 'models' would reduce income inequality; meanwhile, they would reduce administrative and compliance costs, tax avoidance and evasion, and distortionary/disincentive effects.

Besides, the enhancement of efficiency in tax legislation and administration is supposed to have positive effects on equity and efficiency. This is influenced by some scholars' views on the efficiency of the economy for public expenditure programmes as quoted in Marshall: -

> "Some observers argue that efficiency should always be the main criterion for judging public expenditure programmes since only if the economy is efficient in every respect can the income available for redistribution be maximised; in other words, reducing inequality depends upon reducing inefficiency."[104]

When the above perception is applied to this research, it is then arguable that any means that will encourage efficiency of taxation is likely to promote equity as well.[105] *The enhancement of efficiency in tax legislation and administration* is supposed to encourage efficiency of taxation. Therefore, this research will focus on any possible means that could make tax legislation and administration more efficient. Greater efficiency in tax legislation and administration probably results from *improvements in the legislative process, delegated legislation, judicial interpretation, administrative practice and methods of tax collection*. These ways are believed to

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[104] Marshall, op.cit.(note31), p.354

[105] Conversely, if we opted to use any possible means to promote equity (for example, the use of very high marginal tax rates or more tax-free incomes), this would create incentives for tax avoidance and evasion, thereby increasing inefficiency of taxation.

increase efficiency of taxation. Consequently, such an increase will facilitate greater equitable redistribution of income simultaneously.

In conclusion, the enhancement/improvement of efficiency in tax legislation and administration (to be discussed in Chapter Five) will be a further novel/original way to have positive effects on both efficiency and equity additional to the establishment of optimal tax structures (to be discussed in Chapters Two, Three and Four).

12. How successful are optimal tax structures?

As we saw, despite promoting equity, PIT probably has adverse effects on efficiency. This conflict would be intensified if policy-makers placed more weight on equity. However, if policy-makers wanted to promote efficiency without regard to equity, this would not reduce the conflict because this would undermine equity.[106]

The main components of PIT are factors that bring about equity or inequity, efficiency or inefficiency. Therefore, as proposed earlier, the optimal components of PIT will be established to be 'models' to strike the balance between equity and efficiency to reduce the conflict.

It is safe to say whether or not the conception of optimal tax structures or the proposed models will successfully be implemented depends on three significant factors, namely (a) a limited tax policy, (b) simple and certain legislation, and (c) prevention of tax avoidance and evasion. In other words, the significance of these factors should be attached (or jointly considered, where appropriate) to optimal tax structures that will be established.

Limited policy

A conflict between equity and efficiency results from tax policy. As noted above, if policy-makers increased equity, this would reduce efficiency, and *vice versa.* Mankiw notes that "people disagree about tax policy often because they attach different weights to these two goals."[107]

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[106] If policy-makers wanted to promote efficiency by reducing (a) distortionary/disincentive effects, (b) administrative and compliance costs, or (c) tax avoidance and evasion, there could be a restriction on redistribution.

[107] Mankiw, op.cit.(note36), p.257

For example, tax rates involve the use of tax policy to gain political support.[108] Similarly, "the rate is often the most important point politically or commercially."[109] However, if tax rates were set very high on the rich to obtain equity to the greatest extent (for the purpose of gaining political support from the poor), they would lead to tax avoidance and evasion. Tax reliefs can also be used for political purposes. As Morse and Williams say, "granting an exception is very easy politically, and votes are not easily won for removing it later."[110] However, the extensive use of tax reliefs contributes to legal complexity, provides tax loopholes, distorts resource allocation, and reduces tax revenues.

Therefore, if we restricted the use of tax policy (or the role of political forces/influences) on PIT structures, this would bring about optimal tax structures to reduce the conflict between equity and efficiency. For example, if tax rates were restricted to be set optimally, they would achieve equity to the optimal extent which would reduce incentives to avoid and evade tax. Besides, if tax reliefs were restricted only to relieve the tax burden on low-income earners (or they were not used to achieve multi economic and political purposes), they would reduce income inequality while reducing complexity, providing less loopholes, minimizing distortion in resource allocation, and increasing tax revenues.

As proposed in section 11, this research seeks solutions to reduce the conflict between equity and efficiency via possible reform/changes in any questionable component of substantive PIT law. Such solutions will be brought forward after examining and comparing substantive law. Here, it is further proposed that such solutions will be proposed after examining and comparing substantive law together with studying and analyzing the underlying tax policy. This is because substantive law cannot be enacted properly without the underlying tax policy.

The underlying tax policy (which will become the government's tax proposals) mostly originates from theoretical concepts or hypotheses and empirical

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[108] Vito Tanzi and Howell Zee, Tax Policy for Developing Countries (Washington, D.C.: International Monetary Fund, 2001), 6.
[109] Morse and Williams, op.cit.(note15), p.13
[110] ibid.p.13

evidence on interrelated subject-matter, particularly economics.[111] Therefore, the study and analysis of the underlying tax policy will involve discussion of theories or assumptions, empirical evidence, facts, numbers and statistics in the interrelated subject-matter.

The above discussion (which will be made in Chapters Two, Three, and Four) will help the examination and comparison of substantive law to identify the extent to which the components of PIT lead to conflict between equity and efficiency. Additionally, the above discussion will enable this research to make logical arguments for limiting the use of tax policy on PIT structures. This limitation would lead to the reform of any questionable component of PIT.

Therefore, a limited policy is significant to optimal tax structures that will be proposed. In other words, the proposed models in this thesis would not be put into effect unless there were policy changes.

Simple and certain legislation

A limited policy on tax structures is supposed to make legislation less complex while promoting equity. It is further supposed that optimal tax structures would make legislation much less complex while still promoting equity when enacted to become tax law if its expressions are simple and certain.

The World Bank also argues that "reform of tax structure is generally more effective when accompanied by improvements in tax administration."[112] Simple, certain and convenient methods of tax collection are believed to implement optimal tax structures successfully. This is because these types of methods would reduce administrative and compliance costs, and prevent tax avoidance and evasion.

Simple and certain legislation, and simple, certain and convenient methods of tax collection are therefore significant to the reform of PIT structures. And these characteristics of tax legislation and administration are believed to enhance efficiency in tax legislation and administration. Given this, this research will seek out the criteria of simplicity, certainty and convenience in Chapter Five.

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[111] The production or design of the government's tax proposals may also result from other factors, such as public consultation, pressures from certain groups of people, and a desire to gain political support.

[112] The World Bank, Lessons of Tax Reform (Washington, D.C.: The World Bank, 1991), 61.

Prevention of tax avoidance and evasion

As we saw, tax avoidance and evasion discourage efficiency. In addition, they bring about inequity because some people can avoid and evade tax whereas others cannot. And they thwart income redistribution. As Sandford notes,

> "Evasion generates its own redistribution of income - a redistribution from the honest to the dishonest (or from these with less opportunity to evade to those with more opportunity)."[113]
>
> "Avoidance involves its own redistribution of income as between avoiders and non-avoiders (the sophisticated and unsophisticated). Furthermore the rich, who can afford the 'best' advice, are those best placed to take advantage of avoidance possibilities, so that redistribution as a result of avoidance is regressive in its incidence"[114]

The prevention of tax avoidance and evasion is therefore vital to equity and efficiency. Sufficient penalties (e.g. those imposed on people who file incorrect tax returns (such as overstating tax reliefs) or fail to file tax returns and pay tax) and criminal prosecution (in the case of fraudulent evasion) can help prevent tax evasion. Tax avoidance can be prevented through statutory anti-avoidance rules or judicial anti-avoidance rules.[115]

Additionally, as we saw, the main components of PIT (such as tax reliefs and high tax rates) encourage tax avoidance and evasion. Therefore, if PIT structures were properly reformed to become optimal tax structures, this would also help prevent tax avoidance and evasion, which would have positive effects on equity and efficiency.[116] The Tax Law Review Committee (TLRC) supports structural reform to combat tax avoidance. As it says, "one approach to tax avoidance is to reform those structural elements of the tax system that create the opportunities for avoidance."[117]

The significance of prevention of tax avoidance and evasion should therefore be attached to the reform of PIT structures.

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[113] Sandford, op.cit.(note58) p.158
[114] ibid.p.160
[115] This will be discussed in Chapter Five.
[116] "........................" in Chapters Two, Three and Four.
[117] TLRC, op.cit.(note7), 6.

13. How could the conception of optimal tax structures and related matters be adapted elsewhere?

In this thesis, there are two kinds of proposals, namely (a) a general principles proposal, and (b) a specific-detailed proposal.

As regards (a), this research aims to reform any questionable component of PIT, and to examine and improve three significant factors which will implement the conception of optimal tax structures. Therefore, this thesis will put forward a conceptual or theoretical framework of optimal tax structures, a limited tax policy, the criteria of efficient tax legislation and administration, and the prevention of tax avoidance and evasion.

As regards (b), based on a conceptual or theoretical framework in (a), there will be detailed proposals for:

- reforming the components of substantive PIT laws of Thailand and the UK, and
- improving tax legislation and methods of tax collection in Thailand and the UK.

It is supposed that a general principles proposal could be adapted for employment in another place than in Thailand and the UK; meanwhile, a specific-detailed proposal might be adapted where it is appropriate for each particular country.

For example, this thesis will establish the advantages of a two tax-rate schedule system. This system consists of a schedule for low-income groups and a schedule for high-income groups, and each schedule contains few and optimal marginal tax rates. This system is a structural proposal of optimal statutory marginal tax rates (or the frame and benchmark of rate progressivity). This system is supposed to reduce the role of political forces in the tax rate schedule while helping PIT to achieve both equity and efficiency. As this system is a structural proposal, it could be adapted for employment in countries which adopt the system of progressive income taxation.

Another example is that a conceptual framework for limiting the use of tax policy on tax reliefs will be proposed. For instance, a conceptual framework for removal of certain tax expenditures to promote equity and efficiency will be proposed. This framework will contain tax expenditures, such as those leading to tax avoidance and tax arbitrage.

Based on this framework, the exemption of any form of return on financial products or savings (under Thai and UK laws) could be abolished. This is because tax avoidance may involve the exploitation of tax exemption[118], and this exemption probably provides incentives for the wealthy to manipulate their capital income (under contrived schemes) to obtain a tax advantage from it. Lymer, et al., note,

> "[Saving] money in an ISA [or Individual Saving Accounts] rather than an ordinary Building Society account has the result that income from the account is paid without deduction of tax. This therefore is a (legal) scheme which enables taxpayers to avoid paying tax on investment interest received.[119] Individuals may also attempt to avoid paying tax by using more elaborate schemes devised by tax planning experts who try to exploit loopholes in the tax legislation."[120]

Based on the above framework, other countries that use tax policy measures to encourage certain saving and investment activities (which probably lead to tax avoidance schemes) might consider changing this policy and abolishing the exemption of any form of return on financial products or savings.

Another example is that a theoretical framework for simplicity, certainty and convenience of tax law and administration will be sought out. Based on this framework, the improvements of the legislative process, primary and secondary legislation, judicial interpretation, administrative practice and methods of tax collection in Thailand and the UK will be proposed.

For instance, a theoretical framework for certainty requires rules on the structural elements of PIT to be clear, reliable, foreseeable and non-arbitrary. Based on this framework, Thai and UK primary and secondary tax legislation should be written from a detailed viewpoint, and the Thai and UK courts should interpret clear

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118 J.A. Astin, "Discussion", Income Redistribution: the Limits to Redistribution, David Collard, Richard Lecomber and Martin Slater, eds. (Bristol: Scientechnica, 1980), 163.

119 The exploitation of tax exemptions that Parliament has introduced is likely to be acceptable tax planning. But the use of contrived schemes to exploit tax exemptions in a manner contrary to what the legislation seeks to achieve is likely to (unacceptable) tax avoidance.

120 Andy Lymer, et al., Taxation: Policy and Practice, 10th ed., (Birmingham: Accounting Education, 2003), 1/20

words with strictness (however, a purposive interpretation should be applied where it can prevent tax avoidance). The above framework and specific improvements are likely to be adapted for employment elsewhere.

Another example is that a conceptual framework for statutory anti-avoidance rules will be sought out. This framework will partly require statutory anti-avoidance rules to bring about legal certainty and not to give excessively discretionary powers to the tax authorities. Based on this framework, the UK Revenue should not construe and apply disclosure rules and targeted anti-avoidance provisions beyond the strict letter of the law. This framework and specific improvements are likely to be adapted for employment elsewhere which adopts statutory anti-avoidance rules.

14. The efficacy of solutions under optimal tax structures

PIT would become a good direct tax via optimal tax structures to be implemented because of a number of significant factors. This is because its operation is supposed to solve the conflict between equity and efficiency. This solution would have positive effects on the two, namely:

(a) a more equal distribution of income *after* tax,

(b) legal simplification, which would reduce administrative and compliance costs,

(c) discouragement of tax avoidance and evasion,

(d) minimization of distortion in people's economic behavior and resource allocation, and

(e) an increase in tax revenues.

Capital gains are liable to CGT because they are "just as much relevant to ability to pay as income liable to income tax and therefore should be taxed on grounds of equity, both vertical and horizontal."[121] However, as we saw, CGT is not a powerful tool to transfer resources from the rich to the poor for reducing vertical inequity. This is partly because there are many exemptions and reliefs applying to CGT under UK law. In Thailand, capital gains are liable to PIT; but many forms of them are exempted from PIT.

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[121] Tiley, op.cit.(note6), p.650

PIT would bring about a more equal distribution of income *after* tax partly because of the proposed optimal tax base. The proposed optimal tax base would be partly obtained by the maintenance of tax reliefs that benefit low-income earners, and by the abolition of certain tax exemptions and itemized deductions (under Thai and UK law), e.g. the abolition of the tax exemption of capital gains (under Thai law), and the abolition of the deduction of contributions paid to personal pension funds (under both laws). The result of the abolition is likely to offset a disadvantage of CGT, as mentioned above.

In the UK, CGT "is potentially important as an anti-avoidance measure, as it discourages wealthier individuals from converting a large part of their income into capital gains in order to reduce their tax liability."[122] CGT would further help reduce vertical inequity and promote efficiency simultaneously if it adapted the conception of optimal tax structures.

For example, if we restricted tax policy on exemptions and reliefs applying to CGT[123], this would help prevent wealthier individuals from converting their income into assets which are not charged to CGT when they were sold. The consequence of this restriction is that the rich would pay more in CGT while reducing legal complexity, providing less loopholes, minimizing distortion in resource allocation, and increasing tax revenues.

As noted above, capital gains are as much relevant to ability to pay as income liable to income tax and should be taxed on equity grounds. The two tax-rate schedule system which will be proposed to apply to PIT is supposed to promote equity and efficiency. Therefore, if capital gains were taxed under the proposed two tax-rate schedule system, this would help CGT to achieve equity (like PIT) while promoting efficiency.

As discussed earlier, PIT embraces many complex tax provisions, and "with corporation tax, [income tax] is the most complex tax [in the UK]."[124] PIT under the conception of optimal tax structures would embrace less complex provisions due to a limited tax policy and simple and certain legislation. Consequently, with CT,

[122] Adam and Browne, op.cit.(note75), p.17
[123] Exemptions and reliefs should be provided only to the disposal of assets of low-income earners.
[124] Morse and Williams, op.cit.(note15), p.11

income tax would become a less complex tax, which would reduce administrative and compliance costs.

For the CT system, it could help reduce administrative and compliance costs, if it adapted the conception of optimal tax structures. For example, the proposed two tax-rate schedule system which contains few and optimal tax rates would generate simplicity, and discourage tax avoidance and evasion. If the CT system has few and optimal tax rates, it is likely to obtain the similar end result. In addition to optimal tax rates, the proposed optimal tax base that broadens the tax base of PIT by limiting tax reliefs would simplify legislation, discourage tax avoidance and evasion, minimize distortion in resource allocation, and generate more tax revenue. The CT system would obtain the similar end result if it had a broad tax base (by limiting the excessive deduction of current expenditure from taxable profits, e.g. limiting tax relief for current expenditure on R&D).

It is noted that "companies should be taxed because they lock in capital which should reach the shareholders."[125] After a company pays CT on its profits, it makes distributions to its shareholders. As one says,

> "A company does not exist in isolation and the shareholders who invest in it expect to get some financial benefit when the company makes a profit. A company confers some benefit on its shareholders in the form of distribution which it makes from time to time. The distribution will usually take the form of a dividend."[126]

Company dividends paid to individuals are subject to PIT or income tax.[127] In Thailand, as with other incomes, dividends are charged with PIT at rates in the tax-rate schedule. Meanwhile, in the UK, dividend income is charged at different rates from non-savings income and from non-dividend savings income. In Chapter Two, this thesis will propose that dividend and interest incomes (unearned incomes) should be taxed at the same rates as other earned incomes (i.e. rates under the proposed two tax-rate schedules). This is supposed to promote equity, simplify legislation, discourage tax avoidance and evasion, and not to create disincentive to invest.

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[125] Tiley, op.cit.(note6), p.815

[126] CCH Tax Handbook, op.cit.(note12), p.2041

[127] Under Thai and UK laws, the recipients of dividends will receive a tax credit (to be discussed in Chapters Three and Five).

From the above, the conception of optimal tax structures could be applied to CGT and CT (where appropriate) in addition to PIT. Besides, the solutions to the conflict between equity and efficiency could be effected when PIT applied this conception and operated with CGT and CT. Despite this possibility, this efficacy of PIT may impede international tax competition. It is noted that "there is strong tax competition between states [;] [tax] systems are as much part of the global marketplace as any other aspect of a country."[128] Therefore, to attract/encourage domestic and foreign direct investment and to prevent the mobility of capital and income, tax systems in any country may require low tax rates and tax incentives.

Tax reliefs or tax incentives that are provided for encouraging certain industries or saving and investment activities probably attract saving and investment in the country. However, from my viewpoint, PIT should be used only for redistributive and revenue-raising purposes. If PIT were used for many other purposes, this would affect equity and efficiency. This thesis therefore puts forward an idea of a restriction of tax policy on tax reliefs, such as the proposal for the abolition of the tax exemption of capital gains, and the abolition of the exemption of any form of return on financial products or savings.

A restriction of tax reliefs/tax incentives above and the same tax treatment of unearned and earned incomes are unlikely to have severe effects on saving and investment trends in the country which will adopt or adapt the conception of optimal tax structures. This is for the following reasons.

First, "as a matter of fact, tax incentives would be fruitless, if taxpayers disregard the tax factor in their business decisions."[129] Similarly, "income tax exemption was considered a very weak stimulant; those investors, who did consider it, did it only marginally."[130]

Secondly, tax reliefs/tax incentives and the different tax treatment for unearned and earned incomes are unlikely to be the only factors to prevent the mobility of capital and income, and to encourage domestic and foreign direct investment. According to one investor's comment, "tax exemption is like a dessert; it

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[128] Morse and Williams, op.cit.(note15), p.10
[129] Cooper, op.cit.(note95),p.21
[130] Jacques Morisset and Neda Pirnia, How Tax Policy and Incentives Affect Foreign Direct Investment: A review (Washington, D.C.: The World Bank, 2000), 5.

is good to have, but it does not help very much if the meal is not there."[131] The meal or other factors influencing the decline and the increase in saving and investment include interest rates, the run-up in equity values, cheap labor costs, raw materials, a country's economic infrastructure, the stability of political system, and less corruption by government officials.

Thirdly, optimal tax rates in the proposed two tax-rate schedules, and simpler and clearer tax legislation (as to be proposed in this thesis) are likely to offset a restriction of tax reliefs and the same tax treatment of unearned and earned incomes.

15. Conclusion

There are two purposes of this thesis. The first is to examine and compare the main components of the Thai and British PIT laws to establish to what extent they can cause conflict between equity and efficiency. The second is to validate hypotheses that (a) optimal tax structures and (b) the enhancement of efficiency in tax legislation and administration could strike the balance between equity and efficiency.

PIT can make the distribution of income after tax more equal because of the progressive nature of taxation, taxation on income and capital receipts, and tax reliefs. However, these components have adverse effects on efficiency because they cause legal complexity, tax loopholes, distortion in economic decisions and resource allocation, and a loss of tax revenues. The conception of optimal components of PIT is therefore put forward to reduce the conflict.

Optimal tax structures would reduce income inequality; meanwhile, they would simplify tax legislation, discourage tax avoidance and evasion, minimize distortionary/disincentive effects, and increase tax revenues. Additionally, the enhancement/improvement of efficiency in tax legislation and administration is supposed to encourage efficiency of taxation, which would facilitate greater equitable redistribution of income simultaneously.

The conception of optimal tax structures is likely to be implemented by a limited tax policy, efficient tax legislation and administration, and the prevention of tax avoidance and evasion. Although the thesis is theoretical, the principles could be applied practically. In other words, a conceptual framework of optimal tax structures

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[131] ibid.p.5

and related matters is likely to be adapted for employment elsewhere. Additionally, the conception of optimal tax structures could be effected when other components of a tax system are taken into account (as discussed above, PIT under this conception could operate with CGT and CT). This conception is likely to be applicable to CGT and CT (where appropriate) as well. However, the thesis is deliberately restricted to the framework for PIT because it serves as the best example for the strategies suggested; and because in most systems the PIT is the largest and the most fundamental component of the totality of the tax system.

Chapter Two

Optimal Statutory Tax Rates

1. Introduction

This chapter examines the effects of the progressive rate structure under Thai and UK laws on equity and efficiency. Average and marginal tax rates, single and multiple rate systems, and factors and effects of the progressive rate structure in practice will be taken into account in analyzing the effect on equity. In analyzing the effect on efficiency, the disincentive effect and the effect on administrative and compliance costs will be taken in account.

Afterwards, the conflict between equity and efficiency caused by the progressive rate structure will be discussed. Finally, I will propose optimal statutory tax rates to solve the conflict.

2. Concepts of the progressive rate structure and its effects on equity and redistribution

2.1 The progressive rate structure in principle

The PIT system can achieve vertical equity/redistribution by applying a progressive structure and the ability-to-pay principle.

A progressive structure requires an average tax rate ("ATR") which rises with an increase in income.[132] The ATR[133] represents the proportion of income to be taken in tax.[134] Thus, the structure of progressive tax rates ("the progressive rate structure") which is part of a progressive structure is required to change ATRs at different income levels. Consequently, the progressive rate structure, which relies on higher ATRs with higher income, achieves vertical equity/redistribution.

There are two approaches to the progressive rate structure.

The first approach requires one positive rate to be applied to income above an exempt amount (or income after the subtraction of allowable reliefs).[135] The exempt

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[132] James and Nobes, op.cit.(note5), p.14
[133] The ATR is the total sum of tax paid per period divided by total income derived in that period.
[134] Kay and King, op.cit.(note60), p.12
[135] ibid.p.12

income is deemed a zero rate; and a single positive rate above such income is progressive. This approach is referred to as a single rate system.

Another approach is a multiple rate system. This approach requires a number of different marginal tax rates ("MTR")[136] to be applied to different levels of taxable income, namely lower rates are applied to smaller taxable incomes, and higher rates are applied to larger taxable incomes.[137]

It has been found that the single and multiple rate systems can constitute a progressive rate structure because both cause the ATR to rise as income increases. Example 2.1 in **Appendix I to Chapter Two** will illustrate this point.

2.2 Redistribution through the progressive rate structure in principle

To achieve a significant degree of vertical equity/redistribution, the progressive rate structure is required to (a) reduce the tax burden on low incomes[138], and (b) increase the tax burden on high incomes.[139]

Method (a) requires low MTRs for the low-income group.[140] Method (b) means increasing MTRs[141] to obtain high ATRs paid by the rich.[142] High ATRs can be achieved by several methods including (1) having high MTRs on the largest incomes[143] on the tax-rate schedule[144], or (2) maintaining steeply graduated rates.[145]

The question arises whether both single and multiple rate systems can effectively reduce the tax burden on low-income earners and increase it on high-income earners. Although the single and multiple rate systems can increase the level of ATRs as income rises, the multiple rate system is likely to be more successful in achieving significant vertical equity/redistribution. This will be analyzed below.

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[136] The MTR is the additional rate of tax applicable to a person's additional income or the next portion of income.
[137] Schnitzer, op.cit.(note22), pp.171-172
[138] D.I. Trotman-Dickenson, Public Sector Economics (London: Heinemann, 1983), 93.
[139] Slemrod and Bakija, op.cit.(note63), p.5
[140] John Black, A Dictionary of Economics (Oxford: Oxford University Press, 1997), 375.
[141] John Tiley, Revenue Law, 4th ed. (Oxford: Hart Publishing, 2000), 8.
[142] Whittington, op.cit.(note53), p.159
[143] Silverman, op.cit.(note43), p.23
[144] Whittington, op.cit.(note53), p.159
[145] Silverman, op.cit.(note43), p.23

2.2.1 A multiple rate system

If the progressive rate structure is based on a multiple rate system, the MTR is always greater than the ATR because of increasing MTRs on larger taxable incomes. If the MTR is raised, so will the ATR rise.

If MTRs are made higher on the earnings of those with high incomes, a high level of ATRs on the rich will come about and result in the achievement of significant vertical equity/redistribution. Conversely, if the MTR is lowered, there will surely be a decrease in the ATR. Therefore, if MTRs are lowered on the earnings of those with low incomes, there will be a low level of ATRs on the poor. This will also result in the achievement of significant vertical redistribution. Example 2.2 in **Appendix II to Chapter Two** will illustrate these points.

2.2.2 A single rate system

A large tax-exempt income and a single positive rate are the elements of a single rate system. These elements may however prevent high ATRs on high-income groups. A large tax-exempt income helps constitute the progressive rate structure. However, the larger the tax-exempt income, the lower the level of ATRs on the rich.[146] This affects vertical equity/redistribution. Example 2.3 in **Appendix III to Chapter Two** will illustrate this point.

As with a larger tax-exempt income, a single positive rate may prevent high ATRs on high-income groups. In theory, a single positive rate may be set high to impose higher ATRs on the rich for redistributive purposes. However, a single positive rate is unlikely to be set too high in practice because low- and middle-income groups will suffer. Thus, a moderate single positive rate ("MSPR") may be required. As tax-exempt income is deemed a zero rate, the MSPR is the marginal tax rate. As a result of the MSPR, the ATR will not be higher than the MSPR. Consequently, under a single rate system with the MSPR, the level of ATRs on the rich will not be high, which affects vertical equity/redistribution. Example 2.4 in **Appendix IV to Chapter Two** will illustrate this point.

2.3 Relevant tax provisions

Under Section 48 (1) of the Revenue Code of Thailand ("the RCT"), the net/taxable income, arrived at by subtracting allowable reliefs from the assessable income, shall be charged with tax at rates set forth in the tax-rate schedule. During the period of 2000-2005, the schedule which applies to all type of income is as follows:

Bands of taxable income (baht)			**Tax rates**
0	-	100,000	5%[147]
100,001	-	500,000	10%
500,001	-	1,000,000	20%
1,000,001	-	4,000,000	30%
		over 4,000,000	37%

The main provision on tax rates under UK law is Section 1 (2) of the Income and Corporation Taxes Act 1988 ("the TA 1988").[148] According to Section 1 (2), rates of income tax for individuals for 2004-05 are as follows:

Tax rates	(%)	**Bands of taxable income** (£)
Starting rate	10	0-2,020
Basic rate	22	2,021-31,400
Higher rate	40	over 31,400

This structure applies to non-savings income. As regards non-dividend savings income and dividend income, these will be charged at different progressive rates from non-savings income according to Section 1A and Section 1B of the TA 1988 respectively.

According to Section 1A, the rates of tax on savings income other than dividends for 2004-05 are as follows:

Tax rates	(%)	**Bands of taxable income** (£)
Starting rate	10	0-2,020
Lower rate	20	2,021-31,400
Higher rate	40	over 31,400

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[146] The effect of a tax-exempt income will be discussed in Chapter Three.

[147] From the tax year 1999, taxable income from 0 to 50,000 baht is tax-exempt income. From the tax year 2003, taxable income from 0 to 80,000 baht is tax-exempt income. From the tax year 2004, taxable income from 0 to 100,000 baht is tax-exempt income. The tax-exempt income will be discussed in 2.4.4.2

[148] The text of Section 1 (2) can be found in **Appendix V to Chapter Two**.

According to Section 1 B, the rates of tax on dividends for the tax year 2004-05 are as follows:

Tax rates (%)	Bands of taxable income (£)
10	0-31,400
32.5	over 31,400

It should be noted that Section 1 A (5) treats savings income other than dividends as the top slice of taxable income (the top slice). It further treats dividend income as the top slice of savings income or as the highest part of taxable income (the top slice of the top slice).[149] The tax calculation for non-savings income, non-dividend savings income and dividend income is set out in Example 2.5-2.8 in **Appendix VI to Chapter Two**.

2.4 Factors and effects of the progressive rate structure in practice

In this section, I will analyze whether the Thai and UK statutory marginal tax rates ("MTRs") can work under the equity requirement to achieve significant vertical equity/redistribution.

My analysis will focus on whether the tax-rate schedules in question are progressive enough to bring about (a) a low level of ATRs on the poor and (b) a high level of ATRs on the rich ("tax progressivity"). In other words, I will ascertain (a) how low MTRs in the tax-rate schedules apply to the earnings of the poor and (b) how high MTRs apply to the earnings of the rich. For this analysis, the factors behind the tax-rate schedules from the past to the present and how such factors bring about tax progressivity will be examined.

The level of tax progressivity is determined by six factors: -

(1) the revenue target,

(2) political forces,

(3) tax avoidance and evasion,

(4) the number of taxpayers, the level of income and the share of tax paid by different groups of taxpayer,

(5) price inflation, and

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149 Author not identified, Simon's Direct Tax Service:Binder 6: Individuals Schedule E (London: Butterworths, 1995), 1105.

(6) components of a tax base.[150]

2.4.1 Revenue target

The revenue target can affect tax progressivity, which may promote or prevent vertical equity/redistribution. A statement by International Cooperation Administration in 1961 is relevant to this factor. This makes the point as follows:

> "Economists in the industrialized countries of the West often have noted that to raise large amounts of revenue, the income tax must reach down into the brackets of lower income recipients in which are found the greatest numbers of people. Increases in taxes at the upper levels will produce a relatively small increase in total tax receipts as a factor in the total national budget. Small increases at the lower income brackets, however, result in a pronounced increase in total revenue."[151]

From the above, one way of raising more tax revenue is to increase MTRs on lower income recipients. Although small increases in MTRs on lower income levels will obtain higher ATRs on lower income recipients and more tax revenue, this will lead to vertical inequity and thwart income redistribution. As we have seen, ATRs on low-income taxpayers must be as low as possible to achieve tax progressivity. Conversely, imposing heavier tax on high-income taxpayers will enhance tax progressivity.

If the government focuses on the use of the PIT both as a revenue raiser and as a means of income redistribution, it has to choose between tax revenue raised from lower-income taxpayers or tax revenue from upper-income taxpayers. If the latter choice is made, this may generate more tax revenue and achieve vertical equity/redistribution. This choice is however subject to two conditions.

(a) Other factors that reduce ATRs on high-income taxpayers must be removed as far as possible. Such factors include political forces, tax avoidance and evasion, the small number of highest-rate taxpayers, the small income subject to highest tax rates, the small share of tax paid by highest-rate taxpayers, and the effects of tax reliefs on statutory tax rates.

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[150] Factor (6) will be discussed in Chapter Three.

(b) MTRs on high-income taxpayers must be imposed under the concept of optimal statutory marginal tax rates ("OSMTRs").

If the above conditions are met, raising more revenue from high-income taxpayers will (a) enable the revenue target to be met, (b) lead to tax progressivity and achieve vertical equity/redistribution, and (c) least affect efficiency of taxation.

2.4.2 Political forces

How the level of tax progressivity is determined partly depends on the role of political forces.[152] In most developing countries, the poor are the majority population; therefore, it may be argued that a political party that has a tax policy applying strong tax progressivity[153]would probably win a general election in these. This is because it would gain overwhelming support from the majority (the poor) who will benefit from the increase in public services provided by the greater tax revenue taken from the rich.

However, the above supposition may not be true for some countries, for the following reasons.

Firstly, in some countries, high-income earners usually take control of the economic and political systems. Consequently, high-income earners who are in power would hardly allow a tax policy applying strong tax progressivity to lower their income after tax.

Secondly, the rich may resist a political party or put pressure on a government that has a strong policy to increase tax progressivity.

Thirdly, strong tax progressivity possibly deters economic growth because it may create disincentives to work, save and invest. Accordingly, the government may not opt to use a policy of strong tax progressivity.

It appears nowadays that tax-rate schedules in many countries are less progressive, with few tax bands and low MTRs on the rich.[154] Consequently, the lower level of tax progressivity[155] has reduced ATRs on high-income groups. This

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[151] International Cooperation Administration, Modernizing Government Revenue Administration (Chicago: Public Administration Service, 1961), 50.
[152] Morse and Williams, op.cit.(note15), p.13
[153] ATRs are made much higher when income increases up to the high and highest levels.
[154] The World Bank, op.cit.(note112), p.43
[155] ATRs are not made much higher when income increases up to the high and highest levels.

results from political forces. Tiley supports the view that, "of all the aspects of the UK tax system the rates of income tax provide the most striking examples of the influence of history – and of politics."[156] The Musgraves also remark,

> "No absolute statement about the desirability of rate progression can be made on [the grounds of distributive justice and of ability to pay]. The final answer is essentially one of social value judgment and of the balance of political power with which alternative views are advanced."[157]

This research will establish OSMTRs (the framework and benchmark of tax progressivity) to reduce the role of political forces in the tax-rate schedule and to generate efficiency of taxation and benefits for the poor and the rich simultaneously.

2.4.3 Tax avoidance and evasion

2.4.3.1 Tax-avoidance actions and reduction in tax progressivity

High MTRs provide incentives for taxpayers to avoid and evade tax.[158] Tax progressivity is prevented in practice when high-income groups avoid and evade tax as a result of high MTRs. This is because such actions invalidate MTRs and reduce ATRs on the rich. Prest supports the view that "the marginal and effective [average] tax rates which apply [to high-income groups] in principle do not so apply in practice [as a result of tax avoidance]."[159] The UK experience as referred to in Collard (1980) also supports this point, i.e.

> "The apparently progressive schedule at the highest rates is illusory since little income is taxed at these rates. This is due both to evasion and avoidance."[160]

Additionally, tax progressivity is thwarted because tax avoidance and evasion by high-income groups cause low-income groups to pay more in tax but cause high-income groups to pay less. Slemrod and Bakija make the assumption that:

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[156] John Tiley, "General Description: United Kingdom", Comparative Income Taxation: A Structural Analysis, Hugh J. Ault, ed. (Den Haag: Kluwer Law International, 1997), 117.
[157] The Musgraves, op.cit.(note5), p.360
[158] Sandford, op.cit.(note81), pp.159,160
[159] Prest, op.cit.(note40), p.271
[160] Collard, op.cit.(note22), p.6

"If opportunities or predilections for evasion were related to one's level of well-being (for instance, if the rich could evade more easily than the poor), then evasion would make it difficult for us to achieve whatever degree to progressivity we deem to be consistent with vertical equity."[161]

The World Bank also remarks,

"High income tax rates may cause greater concealment of income and use of tax avoidance methods and so on. In [this case] there is the possibility that revenue will be lower at high rates than it is at lower rates."[162]

Further investigations have found three possible factors generating income redistribution from the poor to the rich. These are (a) benefits to the rich, (b) government policy to raise more tax, and (c) the practice of bribery in tax evasion.

(a) Benefits to the rich

Slemrod and Bakija point out that:

"Evasion creates horizontal inequity because people with equal abilities-to-pay end up paying different amounts. …. [T]here is no way for tax rates to be adjusted to offset the advantage gained by the evaders, because we don't know which people are evading".[163]

In terms of horizontal inequity, it is difficult to specify which people are avoiding or evading tax if they have the same taxable capacity. However, if people have different taxable capacity, it is possible to specify which people are avoiding and evading tax. In a comparison between those with less and those with greater taxable capacity, the latter tend to avoid and evade tax due to high MTRs for two reasons.

Firstly, it is worthwhile for the rich to avoid or evade paying tax at high MTRs. As the World Bank notes, "the higher the tax rate, the greater the benefits of avoiding and evading the tax."[164]

Secondly, the rich can afford a professional's fee to find tax loopholes. A survey in the UK (in 2000) found that "rich people seem to have more scope for

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[161] Slemrod and Bakija, op.cit.(note63), p.149

[162] The World Bank Group, "Design elements for administratively simple taxes" http://www1.worldbank.org/publicsector/tax/design.htm, 2.

[163] Slemrod and Bakija, opcit.(note63), p.149

[164] The World Bank, op.cit.(note112), p.30

opting out of taxes by using accountants and avoidance schemes."[165] The OECD also supports the claim that some citizens can avoid or reduce their tax bill, "while others with equal or lower incomes cannot."[166]

Empirical study by Thirsk (1991) supports the conclusion that higher-income groups tend to evade tax more than lower-income groups. It states that,

> "In many of the countries studied, it was estimated that as much as one half of all income tax is evaded and that the greatest opportunities for evading taxes were available to richer rather than poorer taxpayers."[167]

In Thailand, ATRs are mostly paid by wage-earners who are classified as lower-income groups because they cannot avoid tax[168] since their incomes are subject to withholding at source. Meanwhile, most higher-income taxpayers in Thailand are non-labor income earners, the self-employed or professionals who can avoid or evade tax because they can afford fees to find tax loopholes.

(b) Government policy to raise more tax

The government may need to raise tax to offset revenue loss resulting from avoiding actions by high-income groups. The tax increase will inevitably put heavier tax burdens to lower-income groups who evade tax less.

(c) Bribery in tax evasion

In their research on tax incidence in developing countries (1990), Shah and Whalley note, "the redistributive impacts of the bribe system will dominate the direct redistributive effects of the income tax."[169] This is because bribery for tax evasion will cause income redistribution to high-ranking officers who take the bribes and to professionals who often act as intermediaries in the process of bribery.[170] Both high-ranking officers and professionals are classified as high-income groups in developing countries including Thailand. Shah and Whalley conclude in their research that,

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[165] Alan Hedges and Catherine Bromley, Public attitudes towards taxation (London: Fabian Society, 2001), 11.
[166] OECD, op.cit.(note70), pp.43-44
[167] Thirsk, op.cit.(note64), pp.16-17
[168] Tanasai Fugfaipol, "Effective Tax Rates under the Personal Income Tax", RD Tax Journal, Year 44, Volume 10, October 1997, 49-50.
[169] Shah and Whalley, op.cit.(note61), p.34
[170] ibid.pp.34 - 35

"increasing the income tax can thus trigger a reverse distributional process from middle class businessmen and others to wealthy elites."[171]

2.4.3.2 Changes in the tax-rate schedule and reduction in tax progressivity

Methods to reduce incentives to avoid and evade tax owing to high MTRs are required in order to maintain some degree of tax progressivity to achieve vertical equity/redistribution. Such methods are changes in the tax-rate schedule to discourage high-income groups from tax avoidance and evasion.

I have two arguments regarding changes in the tax-rate schedule, which are slightly different from those of other people. These concern (a) tax-rate reduction and evasion and (b) changes in MTRs.

(a) Tax-rate reduction and evasion

Slemrod and Bakija argue that reduction in MTRs is unlikely to reduce evasion. As they state,

> "At first blush the most direct cause of tax evasion is high tax rates. To lower evasion, therefore, one could simply lower tax rates. So the relevant question is whether evasion would be curtailed if [MTRs] were reduced, holding revenues constant, either by making the system less progressive or broadening the base. In either case the quantitative evidence is not decisive. Even on theoretical grounds, the argument that lower rates reduce evasion is not certain."[172]

My research has found that changes in the tax-rate schedule (to reduce incentives to avoid and evade tax due to high MTRs) can be made via four methods (hereinafter called "the four methods") which are:

(i) lowering MTRs,

(ii) reducing the number of tax bands and MTRs, together with widening tax bands,

(iii) setting the top MTR so as not to be considerably different from the top rate of corporation tax, and

(iv) setting the top MTR so as not to exceed 50%.

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[171] ibid.p.35

[172] Slemrod and Bakija, op.cit.(note63), p.157

We have now seen that lowering MTRs as mentioned in Slemrod and Bakija's statement is one method to be applied with others. Slemrod and Bakija comment that lowering MTRs is unlikely to reduce evasion. From my standpoint, it is not enough to look merely at lowering MTRs. It is necessary to look at changes in all components of the tax-rate schedule that will lower high MTRs on high incomes to an acceptable level and ensure a tax-rate schedule that will discourage tax avoidance and evasion.

Lowering MTRs or using any of the three methods can independently reduce ATRs or tax burdens, and are likely to help reduce incentives to avoid and evade tax. However, it would be better if the four methods worked together to reduce incentives to avoid and evade tax. If they did, high MTRs on high incomes would be reduced to an acceptable level and other components of the tax-rate schedule could be effective in discouraging tax avoidance and evasion.

The methods to reduce evasion that I have noted here, including lowering MTRs, are supposed to reduce incentives to avoid and evade tax and are not expected to wipe out tax avoidance and evasion completely. For complete removal of tax avoidance and evasion, other elements in the PIT law, i.e. the tax base, the tax unit, and legislative and administrative processes, must be properly fixed to help the changed tax-rate schedule. Goode supports this point as follows:

> "Many of the practices [of tax avoidance] that have grown up might not be eliminated or even greatly abated if income tax rates were simply reduced, without other reforms."[173]

(b) Changes in MTRs

Thirsk's study (1991) says that in some countries "almost no taxpayer ever paid tax at the highest rate because considerable taxpayer resources were devoted to avoiding that outcome."[174] Additionally, according to Collard (1980), "little income was taxed at these [highest] rates [in the UK.]"[175]

In my view, it may be misleading to think that methods to reduce incentives to avoid and evade tax should emphasize a change in the highest MTR on highest-income taxpayers only. It is probable that changes in MTRs on high- and highest-

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[173] Goode, op.cit.(note73), p.73

[174] Thirsk, op.cit.(note64), p.21

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income taxpayers are both required. This is because tax avoidance and evasion result from the actions of both high- and highest-income taxpayers.

Four methods to discourage tax avoidance and evasion

To discourage high-income groups from tax avoidance and evasion, the four methods as noted above are required.

(i) Lowering MTRs on high incomes

It is accepted that lowering MTRs helps reduce incentives to avoid and evade tax[176]because "the losses are smaller."[177] Furthermore, lowering the top MTR prevents high-income taxpayers from opting out of the PIT.[178] MTRs under Thai and UK laws have now been lowered following this direction.

Under the Thai tax-rate schedule, the top MTR has been reduced to 37% since 1992. It used to be 65%, 55% and 50% during the periods 1982-1985, 1986-1988, and 1989-1991 respectively. Besides, the second-highest MTR has been reduced to 30% since 1992. It used to be 60%, 50% and 40% during the periods 1982-1985, 1986-1988, and 1989-1991 respectively.

In the UK, in 1978-1979, the highest MTR on earned income was 83%, and on unearned income 98%.[179] The 1979 Budget reduced the highest MTR on earned incomes from 83% to 60% and on unearned incomes from 98% to 75%.[180] The highest MTR on earned income has been reduced from 60 to 40% since the tax year 1988-1989. (Additionally, other remaining MTRs on high-income levels before the highest rate were abolished in 1988). The present highest rates are 40% and 32.5% on non-dividend savings and dividend income respectively.

Jeffrey-Cook notes that the top rate of 40% since 1988 has reduced avoidance and evasion.[181] Shipwright and Keeling have a similar view.[182] According to Dilnot and Stears (1998), with the reduction in MTRs "the incentives to evade and avoid at

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[175] Collard, op.cit.(note22), p.6
[176] Thirsk, op.cit.(note64), p.21
[177] The Commission on Taxation and Citizenship, op.cit.(note22), p.107
[178] Saroj Thongprakum, "A Thai Tax System: the Past, Present, and the Future", RD Tax Journal, Year 47, Volume 12, December 2000, 50.
[179] Tiley, op.cit.(note156), p.117
[180] Whittington, op.cit.(note53), p.160
[181] John Jeffrey-Cook, Taxes ancient and modern, http://www.tax.org.uk/showarticle.pl?n=&id=1562&p=1, as of 30/05/2004, 2.
[182] Adrian Shipwright and Elizabeth Keeling, Revenue Law, 2nd ed. (London: Blackstone Press, 1998), 148-149

the margin have fallen over the last fifteen years [in the UK]."[183] This evidence refutes Slemrod and Bakija's argument that lowering MTRs is unlikely to reduce evasion.

(ii) Reducing the number of tax bands and rates, and widening tax bands

It has been found that "too many rates increase tax evasion"[184] and "steep rates contribute to serious evasion of tax."[185] Widening the tax bands and reducing the number of tax bands help reduce the number of MTRs, and thus probably reduce incentives for high-income groups to avoid and evade tax. Thailand and the UK have now changed tax-rate schedules following this direction.

There were thirteen narrow tax bands with thirteen MTRs under the Thai tax-rate schedule during the period 1982-1985, and thirteen slightly widened tax bands with thirteen MTRs during the period 1986-1988. During the periods 1989-1991, these were replaced by six wider tax bands with six MTRs. These six tax bands with six MTRs have been reduced to five wider tax bands with five MTRs since 1992. Additionally, the tax band before the top tax band under the current schedule has been made wider than that under the previous schedule. The width of tax band before the top tax band is 3,000,000 baht. It was 1,000,000 baht during the period 1982-1991.

Under the 2004-2005 UK tax-rate schedule for non-savings income, there are only three MTRs with three tax bands, i.e. the starting-rate band, the basic-rate band and the higher-rate band. Formerly, there were one basic-rate band and many higher-rate bands on incomes in excess of the basic-rate band. For example, during the period 1974-1979, there were one basic-rate band and nine higher-rate bands.[186] During the period of 1979-1988, there were one basic-rate band and five higher-rate bands.[187] From the tax year 1988-89, there was one basic-rate band; the five higher-rate bands were replaced by one higher-rate band. From the tax year 1992-1993 to the tax year 1998-1999, there was one lower-rate, one basic-rate and one higher-rate

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[183] Dilnot and Stears, op.cit.(note62), p.369

[184] The World Bank, op.cit.(note112), p.41

[185] George E. Lent and Teruo Hirao, A Survey of Thailand's Tax Structure (Washington, D.C.:Fiscal Affairs Department, International Monetary Fund, 1970), 35.

[186] Except for the tax year 1978-79, there was a reduced rate band in addition to the basic rate band and the higher rate band.

[187] Except for the tax year 1979-80, there was a reduced rate band in addition to the basic rate band and the higher rate band.

band. From the tax year 1999-2000 to the present (the tax year 2004-2005), there was one starting-rate band replacing the lower-rate band, one basic-rate band and one higher-rate band.

(iii) Setting the top MTR

Setting the top MTR of the PIT so as not to be considerably different from the top rate of corporation tax is likely to reduce incentives for high-income groups to avoid and evade tax. This is because if the top MTR of the PIT is excessively higher than the top rate of corporation tax, high-income groups may choose the corporate way of doing business. Under existing Thai and UK laws, the top marginal personal income tax rates do not differ considerably from the top corporate income tax rates.[188]

(iv) The top MTR not exceeding 50%

The fourth method is to set the top MTR so as not to exceed 50%. The World Bank proposed in 1991 that:

> "It is important to set the top [MTR] at a level that will not result in widespread tax evasion. Thirty to fifty percent is a reasonable range that will avert tax arbitrage."[189]

Similarly, "[MTRs] of 50% or more on income are likely to cause incentives to evade taxes."[190] A survey in the UK (2001) also supported this point that a rate above about 50% would encourage tax avoidance and evasion.[191]

Altogether, the four methods help Thai and UK laws to reduce incentives for high-income groups to avoid and evade tax. However, they reduce tax progressivity.

2.4.3.3 Differences between the reduction in tax progressivity under 2.4.3.1 and that under 2.4.3.2

A reduction in tax progressivity results from either (a) tax avoidance and evasion by high-income groups owing to high MTRs, or (b) changes in the tax-rate schedule via

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[188] The top rate of Thai corporation tax is 30% in 2003. The full rate of UK corporation tax is 30% in 2003-2004.

[189] The World Bank, op.cit.(note112), p.43

[190] Vito Tanzi and Ludger Schuknecht, Public Spending in the 20th Century: A Global Perspective (Cambridge: Cambridge University Press, 2000), 60.

[191] Hedges and Bromley, op.cit.(note165), pp.2 and 34

the four methods to discourage tax avoidance and evasion. Nevertheless, the impact of reduced tax progressivity in each case is different.

Cause (a) has a negative impact on vertical equity/redistribution. Conversely, cause (b) has a positive impact on vertical equity/redistribution. Reduced tax progressivity from cause (b) can maintain sufficient tax progressivity to achieve a measure of vertical equity/redistribution.

2.4.3.4 Changes in the tax-rate schedule and vertical redistribution

The question arises whether a reduction in tax progressivity owing to changes in the tax-rate schedule promotes vertical equity/redistribution. A comparison between losses in ATRs on high-income groups before and after changes in the tax-rate schedule is required. Therefore, the following comparisons need to be investigated: -

(a) the degree of vertical equity/redistribution through the tax-rate schedule before changes in the schedule,

(b) the degree of vertical equity/redistribution through the structure of high MTRs, and

(c) the degree of vertical equity/redistribution after changes in the tax-rate schedule to discourage tax avoidance and evasion.

We have seen that ATRs on high-income groups are reduced by tax avoidance and evasion, which lower the level of tax progressivity. Therefore, it seems that the lower level of tax progressivity cannot achieve satisfactory vertical equity/redistribution. The question then arises whether vertical equity/redistribution at the desired level will be achieved if MTRs are made much higher on the earnings of high-income groups. Sandford suggests an answer to this question as follows:

> "High tax rates intended to achieve a desired redistribution generate evasion, which then necessitates still higher tax rates in order to achieve the desired redistribution, thus generating more evasion. Evasion feeds on itself - the more people evade taxes, the more inequities there are in the operation of the tax system to drive taxpayers towards evasion."[192]

Sandford's idea is convincing: if MTRs are made much higher, taxpayers will face the fact that the loss of their earnings is much higher; or that the gain is much lower. Consequently, there may be more tax avoidance and evasion; and vertical equity/redistribution at the desired level will not emerge.

Conversely, although changes in the tax-rate schedule to discourage tax avoidance and evasion lower the level of tax progressivity, such changes will not substantially reduce the degree of vertical equity/redistribution. This is because there may be fewer losses in ATRs on high-income groups after changes in the tax-rate schedule since attempts to avoid or evade tax are likely to fail. Prest supports this point as follows:

> "The amount of tax really lost by the curtailment of the top bracket rate is likely to be extremely small, when one allows for the reductions in the incentives to avoid and evade."[193]

After comparing losses in ATRs on high-income groups before and after changes in the tax-rate schedule, the following is my answer to the question raised at the outset of this subsection.

Although changes in the tax-rate schedule to discourage tax avoidance and evasion reduce the level of tax progressivity, this reduction offsets the advantage gained by avoiders or evaders before such changes occur. The advantage gained by avoiders and evaders is tax saving. However, this advantage causes revenue loss or makes tax revenue lower than the given rate in the tax-rate schedule, which also affects vertical equity/redistribution.

When changes in the tax-rate schedule occur, incentives to tax avoidance and evasion by high-income groups tend to decrease. This phenomenon is likely to bring back tax revenue from high-income groups at a level close to the given rate in the changed tax-rate schedule. Therefore, it offsets the advantage gained by avoiders and evaders before changes in the tax-rate schedule. This phenomenon also reduces vertical inequity and inequality in post-tax income distribution to some extent (but perhaps not to the desired extent in principle.)

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[192] Sandford, op.cit.(note58), p.159
[193] Prest, op.cit.(note40), p.273

2.4.3.5 Changes in the tax-rate schedule and OSMTRs

The final question concerning avoiding actions is whether reduced tax progressivity resulting from changes in the tax-rate schedule can form part of OSMTRs.

If we look at changes in the tax-rate schedule in terms of the discouragement of tax avoidance and evasion, reduced tax progressivity has caused fewer losses in ATRs on high-income groups. Therefore, reduced tax progressivity in this case to some extent helps achieve income redistribution.

Given this, the tax-rate schedule under the four methods to discourage tax avoidance and evasion is likely to be in agreement with part of OSMTRs, which requires the provision of benefits for the poor.[194]

2.4.4 Number of taxpayers, level of income, share of tax liabilities

Sandford notes that the level of income subject to tax and the proportion of taxpayers need to be taken into account when we want to compare the top rates of two tax-rate schedules (to see which one is higher).[195] However, the share of tax paid by different groups of taxpayer has to be taken into account in determining tax progressivity.

2.4.4.1 Number of highest-rate taxpayers and share of their tax liabilities

The achievement of tax progressivity depends on the number of high- and highest-rate taxpayers. If the number of people paying tax at high and highest rates is great, the following effects are expected: -

(a) a large number of the rich who pay ATRs, and

(b) a large amount of tax revenue contributed by the rich.

However, from past and present experiences in many countries, the number of highest-rate taxpayers is small. This results from two causes.

Firstly, tax avoidance and evasion by highest-income taxpayers result in there being a small number of highest-rate taxpayers in some countries.

Secondly, the top MTR, which is designed to be excessively high applied to a high-income level, means that very few people are subject to this rate. As Sandford

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[194] As noted in subsection 2.4.2, the proposal for a complete structure of OSMTRs is intended simultaneously to provide benefits for poor and rich people.

[195] Cedric Sandford, Why Tax Systems Differ (Bath: Fiscal Publication, 2000), p.51

notes, "in one country the top rate may relate to such a high income level that hardly anyone pays it."[196] The IMF staff's report also says,

> "The effectiveness of a high [MTR] is also much reduced by its often being applied at such high levels of income (expressed in shares of per capita GDP) that little income is subject to these rates. In some developing countries, a taxpayer's income must be hundreds of times the per capita income before it enters the highest rate bracket."[197]

In the past, this phenomenon was also found in the UK. The top MTR applied to a high-income level also resulted in there being a very small number of highest-rate taxpayers (or "higher-rate" taxpayers). There were very few people (not exceeding about 5% of the total number of taxpayers) paying tax at higher rates, resulting in payment of a small amount of tax at these rates.[198] The facts quoted below support this.

> "In 1948/9 there were no less than thirteen different rates of income tax, rising to 95%. Yet the basic rate of income tax, then 36%, applied to incomes up to £30,000 (at 1988 earnings levels). The absurd 95% rate applied only above £250,000 (at 1988 earnings levels), and it is likely that some of the thirteen rates [higher rates] were the [MTR] for only a few thousand, or even hundred taxpayers."[199]

Additionally, there were about 25,000 people paying tax at the top MTR (98%) in 1976-77.[200]

Hence, two inferences can be made from the above theoretical analysis and facts.

Firstly, strong tax progressivity may not be fulfilled owing to (a) the small number of highest-rate taxpayers and (b) a high-income level subject to tax at the highest rate.

Secondly, a top MTR designed to be excessively high is insignificant in practice. This is because (a) this rate relates to a very high-income level, and (b) there are (i) very few people paying tax at this rate, (ii) a small amount of income

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[196] ibid.p.51
[197] Tanzi and Zee, op.cit.(note108), p.7
[198] Kay and King, op.cit.(note60), pp.196-197
[199] ibid.p.197

subject to this rate, and (iii) a small amount of tax paid at this rate. The significance of the highest rate of tax should not be overrated, in view of the small number of highest-rate taxpayers.[201]

The top rates in the current Thai and UK tax-rate schedules have been considerably reduced. Although the top MTR in the Thai tax-rate schedule has been reduced from 65% to 55%, 50% and 37% over the period from 1982 until the present, there was a very small number of highest-rate taxpayers during 2000-2002 (the latest data as found in the website of the Revenue Department of Thailand) as shown in Table 2.1.

Table 2.1

Year	Number of highest-rate taxpayers	Percentage of total taxpayers
2000	14,631	0.27%[202]
2001	17,608	0.29%[203]
2002	19,902	0.32%[204]

Although there have been a very small number and very small proportion of Thai highest-rate taxpayers, the amount and share of tax paid by this group have been very large as shown in Table 2.2.

Table 2.2

Year	Amount of income tax liabilities of highest-rate taxpayers (baht)	Percentage of total income tax liabilities
2000	19,595,281,092	33.06%[205]
2001	24,206,817,476	34.42%[206]
2002	26,674,662,186	31.31%[207]

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[200] Astin, op.cit.(note118), p.163
[201] Kay and King, op.cit.(note60), p.196
[202]**Source**: The Revenue Department of Thailand, http://www.rd.go.th/publish/20525.0.html,as of 04/07/05
[203] "---", http://www.rd.go.th/publish/6103.0.html,as of 04/07/05
[204] "---", http://www.rd.go.th/publish/20524.0.html,as of 04/07/05
[205] "---", http://www.rd.go.th/publish/20525.0.html,as of 04/07/05
[206] "---", http://www.rd.go.th/publish/6103.0.html,as of 04/07/05
[207] "---", http://www.rd.go.th/publish/20524.0.html,as of 04/07/05

Table 2.3 will compare the number and share of Thai taxpayers as well as the amount and share of tax paid by different groups of Thai taxpayer in 2002.

Table 2.3[208]

Group of taxpayers	Number of taxpayers	Percentage of total taxpayers	Amount of income tax liabilities (million baht)	Percentage of total income tax liabilities
Low-rate taxpayers	1,796,107	28.85%	1.31	0.001%
(Lower) Middle-rate taxpayers	3,896,903	63.60%	12,751.31	16.40%
(Upper) Middle-rate taxpayers	362,449	5.82%	12,970.04	16.68%
High-rate taxpayers	149,268	2.40%	25.347.12	32.60%
Highest-rate taxpayers	19,902	0.32%	26,674.66	34.31%
Total	6,073,419	100%	77,744.44	100%

According to Table 2.3, although the amount and share of tax paid by Thai highest-rate taxpayers are large, a change in the Thai tax-rate schedule is still required in order to bring a larger number and proportion of highest-rate taxpayers into the PIT system. This will further bring a much larger amount and share of income tax liability of the rich. This change may be made by widening the present highest-rate band. There are two reasons for this.

Firstly, although a high-income level subject to the top MTR is lowered as a result of reduction in the top rate from 65% to 37%, a taxpayer's income must be nearly fifty times the per capita GDP before it is subject to the top MTR.[209] Lowering the highest-rate threshold is therefore required. This will also make the present highest-rate band wider.

Secondly, a wide tax band does not cause unfairness between taxpayers in the same tax band. It is misleading to think that too wide a range of income in a tax band causes unfairness between taxpayers at the bottom end of a tax band and those at the top end. This misunderstanding results from looking at MTRs only and ignoring ATRs. As discussed earlier, a multiple rate structure relies on the increase of ATRs with higher income, which is implemented by increasing MTRs. Therefore, the

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[208] **Source**: The Revenue Department of Thailand, http://www.rd.go.th/publish/20524.0.html,as of 04/07/05

The definitions of low-rate taxpayers, (lower) middle-rate taxpayers, (upper) middle-rate taxpayers, high-rate taxpayers, and highest-rate taxpayers can be found in **Appendix VII to Chapter Two**.

[209] The evidence is that per capita GDP in 2001 was 81,057 baht, while the highest-rate threshold is taxable income over 4,000,000 baht. (National Statistical Office of Thailand,

difference in tax liability between taxpayers with different incomes is determined by ATRs at different levels of income. The increase of ATRs with higher income should also be taken into account in considering whether a very wide tax band causes unfairness between taxpayers in the same tax band. Kay and King give an example to support this point as follows:

> "It is true that someone who earns £5,000 is liable to tax at the basic rate of 25% [in 1988/1989], and so is someone who earns £20,000. However, the man on £5,000 pays annual tax of £226-equivalent to an [ATR] of 4.5%. His counterpart on £20,000 has to pay £3,976, an [ATR] of 19.9%. The fact that they are both in the [wide] basic rate band does not prevent the man with the higher income from paying a much higher proportion of his income in tax."[210]

Considering the above, I disagree with James and Nobes when they say that the wide tax band causes inequity between taxpayers because "the same marginal rate applies to individuals over a very wide income range."[211] They give an example as follows:

> "For example, in 2000/2001 an individual entitled only to the single person's allowance would pay the same marginal rate of tax [of 22%] whether he or she earned as little as £5,906 or as much as £32,785."[212]

Meanwhile, there has been a small number of British higher-rate taxpayers under the UK tax-rate schedule as shown in Table 2.4.

Table 2.4

Year	Number of higher-rate taxpayers	Percentage of total taxpayers
2002-03	3,070,000	10.44%[213]
2003-04	3,310,000	10.78% [214]
2004-05	3,430,000	11.47%[215]

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http://www.nso.go.th/eng/indicators/core_e.htm,as of 7/12/2002, 1.)

[210] Kay and King, op.cit.(note60), pp.40-41

[211] James and Nobes, op.cit.(note5), p.159

[212] ibid.p.159

[213] **Source**: Inland Revenue, http://www.inlandrevenue.gov.uk/stats/income_tax/it_t01_1.htm,as of 18/03/03

[214] **Source**: Inland Revenue http://www.inlandrevenue.gov.uk/stats/income_tax/it_t01_1.htm,as of 10/09/03

[215] **Source:** Stuart Adam, A Survey of UK Tax System: IFS Briefing Note, BN09 (updated November 2004) http://www.ifs.org.uk/bns/bn09.pdf ,as of 04/07/05, 6.

Although the number of higher-rate taxpayers is small at present, it is larger than it has been in the past. As the IFS paper notes, "the total number of income taxpayers has increased slowly over the years, while the number of higher-rate taxpayers has grown much more quickly, from less than 3% of the taxpaying population in 1979-80 to more than 10% in 2004-05."[216]

Although there have been a comparatively small number and small proportion of higher-rate taxpayers, the amount and share of tax paid by higher-rate taxpayers have been very large as shown in Table 2.5.

Table 2.5

Year	**Amount of income tax liabilities of higher-rate taxpayers (£)**	**Percentage of total income tax liabilities**
2002-03	60,600,000,000	52.3%[217]
2003-04	66,400,000,000	53.3%[218]
2004-05	69,100,000,000	54.5%[219]

Table 2.6 will compare the number and share of British taxpayers as well as the amount and share of tax paid by different groups of taxpayer in 2004-05.

Table 2.6[220]

Group of taxpayers	**Number of taxpayers**	**Percentage of total taxpayers**	**Amount of income tax liabilities (£)**	**Percentage of total income tax liabilities**
Starting-rate taxpayers	4,200,000	14.04%	1,066,000,000	0.8%
Basic-rate taxpayers	22,300,000	74.58%	56,700,000,000[221]	44.7%
Higher-rate taxpayers	3,430,000	11.47%	69,100,000,000[222]	54.5%
Total	29,900,000	100%	126,900,000,000	100%

The IFS paper remarks that the share of income tax liability borne by higher-rate taxpayers has grown since 1978-79, "despite reductions in the higher rates."[223]

[216] ibid.p.25
[217] **Source**: Inland Revenue, http://www.inlandrevenue.gov.uk/stats/income_tax/it_t05_1.htm,as of 18/03/03
[218] **Source:** Inland Revenue, http://www.inlandrevenue.gov.uk/stats/income_tax/it_t05_1.htm,as of 10/09/03
[219] Adam, op.cit.(note215), p.6
[220] This table is adapted from Table 4 in Adam. (ibid.p.6)
The definitions of starting-rate taxpayers, basic-rate taxpayers, and higher-rate taxpayers can be found in **Appendix VII to Chapter Two.**
[221] This amount includes their starting-rate liabilities.
[222] This amount includes their starting- and basic-rate liabilities.

Further to a remark in the IFS paper, since the top MTR was reduced from 60% to 40% and the five higher-rate bands were replaced by one higher-rate band in 1988-89, the share of income tax liability borne by higher-rate taxpayers has grown much more. The greater the reduction in higher rates, the more higher-rate taxpayers have shared the tax burdens.

Table 2.7 will show increases in the share of income tax liabilities borne by the top 1% and the top 10% of income taxpayers who represent higher-rate taxpayers.

Table 2.7: Share of total income tax liability[224]

Year	Top 1% of income taxpayers	Top 10% of income taxpayers	Top rates
1978-79	11	35	83%, 98%
1981-82	11	35	60%, 75%
1986-87	14	39	60%
1990-91	15	42	40%.
1991-92	16	43	40%
1992-93	16	44	40%
1993-94	16	44	40%
1994-95	17	45	40%
1995-96	17	45	40%
1996-97	20	48	40%
1997-98	20	48	40%
1998-99	21	49	40%
1999-2000	21	50	40%
2000-01	22	52	40%
2001-02	22	52	40%
2002-03	21	52	40%
2003-04	21	51	40%
2004-05	21	52	40%

It can be seen from discussion, and the facts and tables above that the gradual reduction of the top rate from 98% to 40% has had the following outcomes.

(1) Such reductions have brought a larger number and proportion of higher-rate taxpayers into the present UK income tax system.

[223] Adam, op.cit.(note215), p.27

[224] Data from 1978-79 until 1986-87 are taken from Table 17 in the IFS paper. (ibid.p.27)
Data from 1990-91 until 2004-05 are taken from Table 2.4 Shares of total income tax liability. (HM Revenue & Customs, http://www.hmrc.gov.uk/stats/income_tax/table2-4.pdf,as of 04/07/05)

(2) Although the number and proportion of higher-rate taxpayers are smaller than those of basic- and starting-rate taxpayers, the amount and share of income tax paid by higher-rate taxpayers are larger than those paid by basic- and starting-rate taxpayers.

(3) The share of tax liability borne by higher-rate taxpayers has steadily grown.

The IFS paper remarks on the quick growth in the number of higher-rate taxpayers from less than 3% of total taxpayers in 1978-80 to more than 10% in 2004-05 as follows:

> "Some of this growth reflects periods when the threshold above which higher-rate tax is due has not been raised in line with price inflation, some reflects the fact that incomes on average have grown more quickly than prices, and some the fact that the dispersion of incomes has grown, with especially rapid increases in the incomes of those already towards the top of the income distribution, pushing more of them into higher-rate income tax liability."[225]

Additionally, earlier facts and discussions show that an increase in the number of higher-rate taxpayers and in the amount of tax liability of higher-rate taxpayers partly results from two achievements consequential on the steady reduction in the top rate, namely (a) the discouragement of tax avoidance and evasion (as discussed in 2.4.3), and (b) the lowering of the high-income level subject to the top rate.

Regarding achievement (b), it is evident that in the past the top rate related to a high-income level subject to it. As we have seen, the excessively high top rate applying to a high-income level generated a small income as very few people were subject to it. Continual reductions in this rate from 98% to 40% helped lower the high-income level. Consequently, the reductions have raised more income and brought a larger number of people into the top rate. This is because a larger amount of income subject to the top rate is supposed to come from there being a larger number of people subject to this rate. Additionally, the larger income subject to the top rate will mean a larger amount and greater share of tax liability at the higher rate.

However, if the higher-rate band were made wider, a larger number and greater proportion of higher-rate taxpayers would be brought into the UK income tax system. This would also generate a larger amount and greater share of tax liability of the rich, resulting in greater tax progressivity. The higher-rate band may be widened by lowering the highest-rate threshold.

2.4.4.2 Number of low-rate taxpayers and share of tax liabilities

There should be a few people paying tax at 'the low rate' or 'the starting rate' to promote tax progressivity. If the number of low- or starting-rate taxpayers is small, a small number of the poor will pay ATRs, and a small amount of tax revenue will be contributed by the poor. This will not cause income to be redistributed too much from low-income groups.

Nevertheless, the number of Thai low- rate taxpayers is not small during 2000-2002 (the latest data as found in the website of the Revenue Department of Thailand) as shown in Table 2.8.

Table 2.8

Year	Number of Thai low-rate taxpayers	Percentage of total taxpayers
2000	1,713,619	32.03%[226]
2001	1,959,489	32.41%[227]
2002	1,796,107	28.85%[228]

Meanwhile, the number of British starting-rate taxpayers is not small as shown in Table 2.9.

Table 2.9

Year	Number of British starting-rate taxpayers	Percentage of total taxpayers
2002-03	3,880,000	13.20%[229]
2003-04	4,300,000	14%[230]
2004-05	4,200,000	14.04%[231]

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[225] Adam, op.cit.(note215), pp.25-26

[226] **Source:** The Revenue Department of Thailand, http://www.rd.go.th/publish/20525.0.html,as of 04/07/05

[227] "--", http://www.rd.go.th/publish/6103.0.html,as of 04/07/05

[228] "--", http://www.rd.go.th/publish/20524.0html,as of 04/07/05

[229] **Source:** Inland Revenue,

The fact that the number and proportion of Thai and British low- or starting-rate taxpayers are not small could mean that: -

(a) a large number of the poor pay ATRs, and

(b) a large amount of tax revenue is contributed by the poor.

However, it cannot yet be concluded that the present Thai and UK tax-rate schedules have failed to achieve vertical equity/redistribution. It is further necessary to take the amount and share of tax liabilities at the low or starting rate under both tax-rate schedules into account.

Table 2.10 will show the amount and share of tax paid by Thai low-rate taxpayers during 2000-2002 (the latest data as found in the website of the Revenue Department of Thailand).

Table 2.10

Year	**Amount of income tax liabilities of Thai low-rate taxpayers** (baht)	**Percentage of total income tax liabilities**
2000	44,564,309	0.07%[232]
2001	726,392,670	1.04%[233]
2002	1,317,920	0.001[234]

http://www.inlandrevenue.gov.uk/stats/income_tax/it_t01_1.htm,as of 18/03/03

[230] **Source**: Inland Revenue http://www.inlandrevenue.gov.uk/stats/income_tax/it_t01_1.htm,as of 10/09/03

[231] Adam, op.cit.(note215), p.6

[232] **Source**: The Revenue Department of Thailand, http://www.rd.go.th/publish/20525.0.html,as of 04/07/2005

[233] "--", http://www.rd.go.th/publish/6103.0.html,as of 04/07/2005

[234] "--", http://www.rd.go.th/publish/20524.0.html,as of 04/07/2005

Table 2.11 will show the amount and share of tax paid by British starting-rate taxpayers.

Table 2.11

Year	Amount of income tax liabilities of British starting-rate taxpayers (£)	Percentage of total income tax liabilities
2002-03	1,020,000,000	0.9%[235]
2003-04	1,040,000,000	0.8%[236]
2004-05	1,066,000,000	0.8%[237]

Although the number and proportion of Thai and British low- or starting-rate taxpayers are not small, the amount and share of tax paid by these taxpayers are very small. This implies that both tax-rate schedules only partly help achieve vertical equity/redistribution. To achieve a greater vertical equity/redistribution at a low-income level, the present number and proportion of Thai and British low- or starting-rate taxpayers should be further lowered. This will further lower the amount and share of tax paid by these taxpayers.

Reductions in the number and proportion of low- or starting-rate taxpayers as well as in the amount and share of tax paid by these taxpayers can be made by:

(a) lowering the low or starting rate,

(b) narrowing the low- or starting-rate band, and

(c) raising the level of income subject to the low or starting rate.

Methods (a) and (b)

These two methods are influenced by the UK experience. In 1999-2000, the 20% lower rate was replaced by a new 10% rate. The new lower rate is known as 'the starting rate' and applies to a smaller amount of taxable income than the 20%

[235] **Source**: Inland Revenue, http://www.inlandrevenue.gov.uk/stats/income_tax/it_t01_1.htm,as of 18/03/03

[236] **Source**: Inland Revenue, http://www.inlandrevenue.gov.uk/stats/income_tax/it_t05_1.htm,as of 10/09/03

[237] Adam, op.cit.(note215), p.6

rate that it replaced.[238] The introduction of the new 10% rate together with a narrower tax band has led to the following outcomes: -

Firstly, the number of starting-rate taxpayers has been reduced.[239]

Secondly, the amount and share of income tax liability at the starting rate have been reduced. This is due to: -

(a) the reduced tax rate,

(b) the smaller amount of income subject to the 10% starting rate, and

(c) the smaller number of people paying tax at the 10% starting rate.

Method (c)

The level of income subject to the low rate or the starting rate set at a low level would subject a large amount of income and a large number of people, in particular the poor, to this rate. Consequently, it would raise the amount and share of tax liability at this rate. If the level of income subject to the low or starting rate were raised, there would be less income and a smaller number of people, in particular the poor, subject to it. Consequently, there would be a reduction in the amount and share of tax paid by low-income people.

Messere has found the facts as follows: -

> "Thresholds, zero rate brackets and first positive rates should logically be discussed together, for while most countries simply have a threshold and then a first positive rate, others have a threshold and a zero rate before a positive rate is reached."[240]

The use of a zero-rate bracket (after a threshold and before a positive rate) is one of ways to raise the level of income subject to the low rate.[241]

In Thailand, a zero-rate bracket has been enacted since the tax year 1999. Before 1999, the low-rate band together with the 5% low rate applied to the first 100,000 baht of taxable income. In 1999, Royal Decree No.352 (1999) was passed to exempt the first 50,000 baht of taxable income from tax.[242] In other words, in 1999

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[238] The 10% starting rate applies to the first £1,500 of taxable income in 1999-2000. In the previous year (1998-1999), the 20% lower rate applied to the first £4,300 of taxable income.

[239] Adam, op.cit.(note215), p.27

[240] K.C. Messere, Tax Policy in OECD countries: Choices and Conflicts (Amsterdam: IBFD Publications BV, 1993), 239.

[241] Another way of raising the tax threshold is by increasing personal tax allowances.

[242] This law was effective from 1st January 1999.

the low-rate band was divided into two portions; the first portion (50,000 baht) was taxed at a zero rate and the second portion (50,000 baht) was taxed at the 5% low rate.

Royal Decree No.352 (1999) was subsequently abolished by Royal Decree No.412 (2002). According to Royal Decree No.412 (2002), the first 80,000 baht of taxable income is tax exempt.[243] In other words, since 2003 the low-rate band has been divided into two portions; the first portion (80,000 baht) being taxed at a zero rate and the second portion (20,000 baht) at the 5% low rate.

Royal Decree No.412 (2002) was subsequently abolished by Royal Decree No. 430 (2005). According to Royal Decree No.430 (2005), the first 100,000 baht of taxable income is tax exempt.[244] In other words, since 2004 the first 100,000 baht of taxable income has been taxed at a zero rate.

The tax-exempt income or a zero-rate bracket for the first 50,000 baht, the first 80,000 baht and the first 100,000 baht of taxable income has applied to the calculation of taxable income by subtracting deductible expenses and tax reliefs from the assessable income in computing the tax liability at the end of the tax year and at withholding of tax at source for income from employment.[245] So, it has not applied to certain withholding of tax at source which does not require the calculation of taxable income by subtracting deductible expenses and tax reliefs from the assessable income, such as withholding at source in relation to payments for the sale of authorship and for the sale of immovable property.[246]

The Revenue Department of Thailand states that the objective of zero-rate bracket is to reduce the tax burdens of the low- and middle-income groups.[247] As we have seen in Table 2.10, during the period when a zero-rate bracket for the first 50,000 baht was in effect, there were the small amount and share of tax liability at the low rate. A zero-rate bracket for the first 80,000 baht and for the first 100,000 baht are expected to bring about the smaller number and proportion of low-rate

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[243] This law was effective from 1st January 2003.
[244] This law has been effective since 1st January 2004.
[245] The group of Thai tax academicians, Taxation According to Revenue Code 2005 (Bangkok: Ruan-Gaow Printing, 2005), 42.
[246] ibid.pp.42-43
[247] The Revenue Department of Thailand, What's New: New measures for the lower income, http://www.rd.go.th/publish/12794.0.html,as of 18/1/46, 1.

taxpayers as well as the smaller amount and share of income tax paid at the low-income level.[248] This is because such zero-rate brackets will raise the income subject to the low rate, removing more people at a low-income level from the PIT system and reducing the amount of income subject to the low rate.

2.4.4.3 Changes in the tax-rate schedule and OSMTRs

To bring about greater tax progressivity and promote income redistribution, the following phenomena are required:

(a) an increase in the number of highest- or higher-rate taxpayers and in the amount of tax paid by these taxpayers, and

(b) a reduction in the number of low- or starting-rate taxpayers and in the amount of tax paid by these taxpayers.

Phenomenon (a) can come about via the widening of the highest- or higher-rate band. Phenomenon (b) can be realized by (i) lowering the low or starting rate, (ii) narrowing the low- or starting-rate band, and (iii) using a zero-rate bracket.

The above changes encourage income redistribution from the rich to the poor. Consequently, they are likely to be in agreement with part of OSMTRs, which requires the provision of benefits for the poor.

2.4.5 Price inflation

Inflation is "persistent increases in the general level of prices."[249] Consequently, the cost of living increases, and nominal income increases to cover the cost of living. When an individual's nominal income and the price level increase at the same rate, his/her real income remains unchanged.[250]

As nominal income increases with price inflation, the taxpayer is pushed into higher tax bands with higher MTRs although his/her real income does not increase.[251] This phenomenon is referred to as "fiscal drag" or "bracket creep."[252]

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[248] At the time of doing this research, no data from the website of the Revenue Department of Thailand is available for 2003 and 2004.

[249] Graham Bannock et al., The Penguin Dictionary of Economics, 6th ed. (London: Penguin Books, 1998), 205.

[250] Harvey S. Rosen, Public Finance, 5th ed. (Boston: Irwin/McGraw-Hill, 1999), 367.

[251] The Musgraves, op.cit.(note5), p.371

[252] James, op.cit.(note2), p.19

Heavier tax burdens as the result of the 'bracket creep' effect, particularly on low-income taxpayers, deter tax progressivity. Similarly, the 'bracket creep' effect "can seriously undermine the progressivity and fairness of [the PIT] because low-income groups will be subject to unduly high [MTRs]."[253]

Tax bands should therefore be widened to keep pace with the price level to maintain their real value and to avoid a tax increase brought about by price inflation. The price level/the rate of inflation is measured by the retail prices index or the consumer price index. The retail prices index is "an index of the prices of goods and services purchased by consumers to measure the rate of inflation or the cost of living."[254] Likewise, it is "the official UK cost of living index."[255] Therefore, tax bands should be annually adjusted in line with changes in the retail prices index.

According to UK law, unless Parliament otherwise determines, the starting-rate band, the basic-rate band, and the higher-rate band (where applicable) are widened annually by the same percentage as the percentage increase in the retail prices index for the previous year. The resultant figure (other than the starting-rate band) and income limits is rounded up to the nearest £100 and in the case of the starting-rate band to the nearest £10.[256] Therefore, UK law relating to the indexation of tax bands can prevent bracket creep.

Meanwhile, Thai law has no provision for adjusting tax bands according to the rate of price inflation. However, the Thai government has changed the tax-rate schedule from time to time to mitigate the effect of bracket creep due to price inflation.[257] The government changed the tax-rate schedule four times between 1982 and 1992. However, there has not been a change in the tax-rate schedule since 1992, although inflation has occurred every year during this period. The rates of price inflation from 1992-2004 were 4.1%, 3.4%, 5.1%, 5.8%, 5.9%, 5.6%, 8.1%, 0.3%, 1.6%, 1.6%[258], 0.7%, 1.8%, and 2.7%[259]respectively. Therefore, "though the

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[253] The World Bank, op.cit.(note112), p.49
[254] Bannock, op.cit.(note249), p.359
[255] Black, op.cit.(note140), p.404
[256] Sections 1(4) (5A) (6), TA 1988
[257] Chaipat Sahasakul, Features of the Tax System in Thailand (Bangkok: Thailand Development Research Institute, 1987), 26.
[258] **Source:** The Bank of Thailand,
http:www.bot.or.th/bothomepage/databank/EconData/Thai_key/Thai_key E.asp,as of 25/07/2005, p.1

government has so far tried to offset the bracket creep effect due to inflation for low-income and middle-income taxpayers, it can only do it partially."[260]

It is clear that without indexation provision, inflation, through bracket creep, increases tax burdens on taxpayers. Additionally, occasional changes in the tax-rate schedule are not good enough to maintain the real value of tax bands to completely counteract bracket creep. The US experience is likely to support this conclusion. According to Brunori, "for many years, the failure of many states to index their income tax systems to inflation has resulted in substantial tax increases without legislative action."[261]

By comparison, UK law is more likely to prevent bracket creep and to bring about tax progressivity than Thai law. The adoption of provisions for price-level indexation should therefore be made into Thai law as is done in UK law. The World Bank supports this suggestion as follows:

> "[In Thailand], equity of the PIT is low. There are no automatic adjustments of brackets ..., so the inflationary effect on rates .... has gradually eliminated much of the progressivity of the rate structure. .... Also, consideration should be given to creating an automatic inflation adjustment methodology to update brackets ... in the PIT."[262]

The annual adjustment of tax bands in line with changes in the retail prices index to prevent the bracket-creep effect due to price inflation would mean a change in the tax-rate schedule. As we have seen, without adjustment of tax bands for price inflation, inflation increases tax burdens on taxpayers although their income remains unchanged. The indexation of tax bands to the price level can maintain the real value of tax bands and avoid an unintended tax increase brought about by price inflation. Therefore, a change in the tax-rate schedule to match inflation benefits all groups of taxpayers. Such change also promotes tax progressivity and vertical

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[259] **Source**: The National Statistical Office of Thailand, Statistical Yearbook Thailand 2004 (Table 19.1 General Consumer Price Index by Region and Commodity Group 2001-2004), (Bangkok: National Statistical Office, 2005), 424.
[260] Sahasakul, op.cit.(note257), p.29
[261] David Brunori, "State Personal Income Taxation in the Twenty-First Century", The Future of State Taxation, David Brunori ed. (Washington, D.C.: The Urban Institute Press, 1998), 198.
[262] The World Bank, Thailand Public Finance in Transition (Washington D.C.: The World Bank, 2000), 27.

equity/redistribution because of a reduction in tax burdens on the poor, which is likely to be in agreement with part of OSMTRs.

3. Concepts and effects of the progressive rate structure on efficiency

Astin remarks that "high [MTRs] may be imposed in order to achieve redistribution or in order to achieve a desired total revenue from a progressive structure, or both."[263]

However, the revenue-raising purpose may not be achieved because high MTRs are believed to produce high costs and great losses in the taxing process, leading to inefficiency of taxation. Likewise, "the criteria of economic efficiency requires low [MTRs]."[264]

To promote efficiency of taxation, the tax-rate schedule must reduce administrative and compliance costs, and losses in the taxing process.

3.1 Administrative and compliance costs

To reduce administrative and compliance costs, the tax-rate schedule should (a) be simple and (b) reduce incentives to avoid and evade tax.

3.1.1 Complex tax system

The tax-rate schedule causes complexity because of (a) the inherent complexity within the tax-rate schedule, and (b) tax rates and bands leading to complexity in other structures of the PIT system.

3.1.1.1 Inherent complexity within the tax-rate schedule

Slemrod and Bakija argue that "a graduated tax rate structure does not, by itself, directly contribute any significant complexity to the taxpaying process."[265] However, I have found that the inherent complexity within the tax-rate schedule causes complexity through the existence of:

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[263] Astin, op.cit.(note118), p.163
[264] IFS, op.cit.(note98), p.12

(a) many MTRs and tax bands, and

(b) the great differential between tax rates on earned income, non-dividend savings income, and dividend income.

As regards (a), The World Bank notes, "the worldwide tax reforms of the Eighties resulted in a real attack on multiple rate structures."[266] This is because the multiple rate structure increases administrative complexity and collection costs.[267] Similarly "when rates are not flat, there is an additional cost of collection in administering graduated rates."[268] As regards (b), The World Bank notes, "too many [different] rates increase the complexity of the tax system."[269]

Additionally, causes (a) and (b) can increase the complexity and the cost of tax compliance. This is because taxpayers who have neither basic nor advanced knowledge of progressive tax rates and various rates are supposed to spend extra resources in dealing with their tax affairs. The survey in the UK (in 2000) pointed out that the British people "are sometimes confused about the effects of thresholds and rates of tax."[270] The survey has also found as follows: -

> "The idea that there are different rates at different earnings thresholds is broadly familiar, but not many people have an accurate grasp of all the actual thresholds and rates."[271]
>
> "There are often signs of ignorance or misconception about specifics-sometimes even about fundamental items like the basic rate of income tax."[272]
>
> "[Many people] sometimes talk as if people pay their highest rate on all their income. So conversation about the 40% higher rate of income tax would sometimes lurch into a false frame of reference as people started speaking as if someone earning (say) £35,000 would pay 40% of their entire income in tax."[273]

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[265] Slemrod and Bakija, op.cit.(note63), p.138
[266] The World Bank Group, op.cit.(note162), p.2
[267] ibid.p.2
[268] Dalton, op.cit.(note30), p.113
[269] The World Bank, op.cit.(note112), p.41
[270] Hedges and Bromley, op.cit.(note165), p.20
[271] ibid.p.19
[272] ibid.p.12
[273] ibid.p.12

Furthermore, the survey notes that the ordinary people do not understand the progressive rate structure and this is the reason for rich people to employ accountants.[274]

This survey was conducted in 2000, when there were few MTRs and tax bands as well as only a slight differential in tax rates between earned and unearned income. It can be inferred that the progressive rate structure is hard to understand even though it is uncomplicated.

It is clear that simplicity in the tax-rate schedule is required and can be achieved by:

(a) reducing the number of MTRs and tax bands, and

(b) reducing the differential in tax rates between earned income, non-dividend savings income and dividend income.

(a) Fewer rates and bands

The World Bank notes, "the numbers of rates [and bands] [have] been greatly reduced in many countries with attendant savings of administrative cost."[275] However, Messere argues that:

> "The reduction of the number of brackets has an appearance of simplicity, but it is unlikely in most countries to have much practical effect. For example, fewer brackets will probably have little effect on tax administrative or taxpayers' compliance costs, since taxpayers will refer directly to details of liabilities at different income levels and in different family circumstances, which are made available by governments and published in newspapers, rather than calculate their liability from the legal schedule."[276]

In my opinion, having fewer rates and bands reduces the inherent complexity within the tax-rate schedule as well as reducing administrative and compliance costs, for two reasons.

Firstly, as a result of there being fewer rates and bands, tax bands are wider. Consequently, the amount of tax deducted at source probably equals the amount of tax liability according to the tax-rate schedule. On this basis, most British taxpayers

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[274] ibid.p.11
[275] The World Bank Group, op.cit.(note162), p.2
[276] Messere, op.cit.(note240), p.239

are not required to file tax returns. This fact can be seen from the operation of the very wide UK basic-rate band. James and Nobes support this, stating that:

> "The main reason for the long band has been that it allows tax to be deducted at source very accurately from the investment income and from any second and subsequent employments of most taxpayers."[277]

Secondly, as a result of there being fewer rates and bands, taxpayers will spend less time understanding the progressive rate structure to calculate and complete their tax returns if returns are required.

At present, tax rates and bands in the Thai and UK tax-rate schedules have been greatly reduced. Therefore, the inherent complexity within both tax-rate schedules has been reduced.

(b) Reduction in rate differential

The great differential in tax rates between earned and unearned income is one factor causing the inherent complexity within the tax-rate schedule. Reducing rate differentials will reduce inherent complexity. Differentials in tax rates on such incomes result from their being taxed through separate schedules.[278] To reduce such differentials, the unification of rate structures is required. It would lead to simplicity of tax administration.[279]

3.1.1.2 Other complexity caused by the progressive rate structure

Tax rates or bands can lead to complexity in other structures of the PIT system, which includes: -

(a) complex legislation to prevent tax-avoidance schemes resulting from high MTRs;

(b) complexity in the taxing process and increased costs of tax compliance and administration resulting from the width of the low- or starting-rate band which brings more poor people into the PIT system.

As regards (a), tax-avoidance schemes caused by high MTRs are complicated[280], which lead to "substantial enforcement problems for tax

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[277] James and Nobes, op.cit.(note5), p.159
[278] The World Bank, op.cit.(note112), p.39
[279] Thirsk, op.cit.(note64), p.22
[280] Slemrod and Bakija, op.cit.(note63), p.139

administration."[281] Problems for tax administration include the administration of complex legislation to prevent tax-avoidance schemes.[282] Complex legislation increases costs for tax-gatherers and taxpayers in administering or dealing with it.

Lowering high MTRs accompanied by three other methods[283] to discourage tax-avoidance schemes (as discussed in 2.4.3.2) probably make tax avoidance and evasion less desirable. Consequently, there will be fewer complex anti-avoidance rules for tax gatherers to administer and for taxpayers to comply with, which will reduce administrative and compliance costs.

As regards (b), the width of the low- or starting-rate band may lead to complexity in the taxing process and increased costs of tax compliance and administration because it increases the number of low-income taxpayers. This tends to incur "compliance costs that are disproportionate to the tax they pay."[284]

As indicated in 2.4.4.2, the amount and share of tax paid by a large number of Thai and UK low- or starting-rate taxpayers are very small. Therefore, the large number of low-income taxpayers leads to complexity in the taxing process and increased costs of tax compliance and administration without producing a large amount of tax revenue.

To reduce the role of the low- or starting-rate band in causing complexity in the taxing process and increased costs of tax compliance and administration, some of the low- or starting-rate taxpayers should be moved out of the PIT system. As noted in 2.4.4.2, the low- or starting-rate band under the present Thai and UK tax-rate schedules is not too wide as a result of using a zero-rate bracket (under Thai law) and narrowing the starting-rate band (under UK law). In spite of such changes, the number of Thai and UK low- or starting-rate taxpayers is still large. This implies that the low- or starting-rate band may need to be further narrowed to reduce further the number of low-income taxpayers. [285]

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[281] The World Bank Group, op.cit.(note153), p.2
[282] ibid.p.2
[283] except for expanding the low- or starting-rate band
[284] The World Bank Group, op.cit.(note162), p.2
[285] To further remove low-income taxpayers out of the PIT system, the following methods can be made to further narrow the width of the low- or starting-rate band: -

(a) to use a zero-rate band for the first amount of taxable income and to adjust such band in line with price inflation in each tax year; and

3.1.1.3 Changes in the tax-rate schedule and OSMTRS

My research so far suggests that the following are required to reduce administrative and compliance costs:

(a) a reduction in the inherent complexity of the tax-rate schedule, and

(b) a reduction in the complexity of other structures of the PIT system.

Simplicity in the tax-rate schedule would lead to phenomenon (a). Such simplicity can be brought about by using fewer rates and bands and reducing rate differentials between earned and unearned income. As regards (b), simpler legislation can be brought about by lowering high MTRs and by three other methods to discourage tax-avoidance schemes. Additionally, narrowing the width of the low- or starting-rate band would reduce complexity and costs of tax compliance and administration.

The above changes in the tax-rate schedule tend to reduce complexity not only in the tax-rate schedule but also in other structures of the PIT system, which reduces administrative and compliance costs. (Reduced compliance costs mean a reduction in other burdens on low- and high-income taxpayers than taxes they pay). Therefore, such changes are likely to be in agreement with the concept of OSMTRs, which requires efficiency of taxation and benefits both poor and rich people.

3.1.2 Tax avoidance and evasion

Tax avoidance and evasion resulting from high MTRs lead to inefficiency of taxation as they cause revenue loss and increased administrative and compliance costs.

As discussed in 2.4.3.2, changes in the tax-rate schedule under the four methods help reduce incentives to avoid and evade tax. However, such changes are made to maintain tax progressivity to achieve an extent of vertical equity/ redistribution because the changes are focused on discouraging high-income groups from avoiding and evading tax. Meanwhile, changes in the tax-rate schedule in this subsection focus on the discouragement of taxpayers at all income levels from tax avoidance and evasion. This is because tax avoidance and evasion by taxpayers at all

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(b) to raise the tax threshold by increasing the amount of personal tax allowances and to adjust such allowances in line with price inflation in each tax year.

income levels lead to greater revenue loss and an increase in administrative and compliance costs.

To reduce incentives for taxpayers at all income levels to avoid and evade tax, MTRs need to be lowered at all income levels. The number of tax bands and MTRs should also be reduced at all income levels. Moreover, the width of tax bands should be expanded at all income levels (except the low- or starting-rate band). The further question arises whether or not changes in the tax-rate schedule following these patterns can reduce revenue loss and administrative and compliance costs.

3.1.2.1 Reduction in revenue loss

Lower MTRs, fewer tax bands and MTRs, and wider tax bands at all income levels (except for expanding the low- or starting-rate band) make tax avoidance and evasion less desirable. The discouragement of tax avoidance and evasion resulting from such changes is likely to reduce revenue loss because such discouragement should reduce losses in ATRs at all income levels.

However, Slemrod and Bakija are against the above inference. They argue that it is uncertain that simply lowering MTRs will hold revenue constant because "the quantitative evidence is not decisive."[286] Their argument is likely to be refuted by the UK and Thai experiences. Brown and Sandford have discovered that:

> "It is quite possible that the 1979 reduction in higher rate income tax in the United Kingdom from 83 to 60 per cent on earned income and from 98 to 75 per cent on investment income may have been responsible for higher revenue yield among those affected, especially because of a reduction in tax avoidance."[287]

Jeffrey-Cook has also found that a reduction in the top MTR to 40% since 1988 has attracted business to the UK and reduced avoidance and evasion, which has brought in more revenue.[288] Lent and Hirao (1970) have found that steep rates under the 1970 Thai tax-rate schedule led to serious tax evasion; however, lower MTRs

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[286] Slemrod and Bakija, op.cit.(note63), p.157

[287] Chuck Brown and Cedric Sandford, "Chapter 9 Tax Reform and Incentives: A Case Study from the United Kingdom", Key Issues in Tax Reform, Cedric Sandford, ed. (Bath: Fiscal Publications, 1993), 217.

[288] Jeffrey-Cook, op.cit.(note181), p.2

would not result in revenue loss if the incentive to evade tax had been reduced together with effective tax enforcement.[289]

3.1.2.2 Reduction in administrative and compliance costs

When incentives to avoid and evade tax have been reduced, administrative costs are likely to be reduced in the following ways.

Firstly, extra government resources may not be needed to research and develop complex legislation to prevent avoidance schemes.

Secondly, when legislation is simpler, extra government resources are unnecessary to administer it.

Thirdly, extra government resources that are used to detect actions of avoidance and evasion and bribery for tax evasion should become redundant.

Compliance costs are likely to fall because honest or unsophisticated taxpayers will spend less in complying with simpler legislation. The expenditure of avoiders and evaders should also become redundant.

3.1.2.3 Changes in the tax-rate schedule and OSMTRS

Changes in the tax-rate schedule (as discussed above) possibly reduce incentives for taxpayers at all income levels to avoid and evade tax, and thus reduce revenue loss, administrative costs and compliance costs for taxpayers at all income levels. Therefore, such changes are likely to be in agreement with the concept of OSMTRs, which requires efficiency of taxation and benefits both poor and rich people.

There are fewer low MTRs and wide tax bands at all income levels in Thai and UK tax-rate schedules at present (except for the narrow low- or starting-rate band). Comparisons between the past and present Thai and UK tax rate schedules in **Appendix VIII to Chapter Two** will help to clarify this point.

3.2 Deadweight loss

It is argued that high MTRs have a disincentive effect, resulting in deadweight loss. This is because high MTRs distort incentives to engage in taxed activities. Therefore, the tax-rate schedule should reduce a disincentive effect.

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[289] Lent and Hirao, op.cit.(note185), p.35

3.2.1 Effects on work decisions

It is argued that "high [MTRs] are relevant to disincentive effects while the [ATR] is relevant to the incentive effect."[290] The disincentive and incentive effects will affect work/labour supply.[291] "Work/labour supply" includes "work effort, occupational choice, and the acquisition of education and job-specific skills."[292]

3.2.1.1 MTR and disincentives to work

It is argued that the MTR is a disincentive to work.[293] This argument may be correct in principle. This is because the MTR is the rate applicable to people's additional income that people earn. Many further believe that high MTRs (e.g. 50% or higher) enhances disincentives to work.[294] This argument may also be correct in principle because an increase in MTRs minimizes the reward from extra working or reduces the incentive to do extra work.[295] On this basis, "almost all economists would agree that [MTRs] in the vicinity of 90 percent are too high to do much good for anyone."[296]

The disincentive effect causes a taxpayer to choose between unpaid and paid work or to substitute untaxed activities or lightly taxed work for high taxed work ("the substitution effect"). More discussion in the substitution effect can be found in **Appendix IX to Chapter Two.**

People's productivity and opportunities to create higher earnings are restrained as a consequence of the substitution effect. Similarly, "high [MTRs] cause people to think twice before adding to their output."[297] Therefore, the disincentive/substitution effect leads to loss in the taxing process. Reducing the disincentive effect has become one of objectives of tax reforms in many countries

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290 Chuck Brown, "Will the 1988 Income Tax Cuts Either Increase Work Incentives or Raise More Revenue?", Fiscal Studies, Volume 9, Number 4, November 1988, 98.

291 Trotman-Dickenson, op.cit.(note138), p.98

292 Slemrod and Bakija, op.cit.(note63), p.108

293 Mankiw, op.cit.(note36), p.248

294 Slemrod and Bakija, op.cit.(note63), p.97; the Musgraves, op.cit.(note5), p.360; Tanzi and Schuknecht, op.cit.(note190), p.60; and the Commission on Taxation and Citizenship, op.cit.(note22), p.225

295 Chuck Brown and Cedric Sandford, "The Effects of Income Tax on Incentives: How the 1988 Income Tax Reduction Affected Accountants", British Tax Review 1991 (London: Sweet & Maxwell, 1991), 414.

296 Slemrod and Bakija, op.cit.(note63), p.97

297 Schnitzer, op.cit.(note22), p.7

since the late 1970s.[298] As high MTRs distort incentives to work, a reduction in high MTRs is supposed to distort less, resulting in a reduced disincentive effect. Many support this point.[299]

The high and very high MTRs on high-income taxpayers tend to produce a greater disincentive effect. Therefore, the proposal to reduce the top rate which is high or very high has been widely supported. For example, the World Bank notes,

> "It is important to set the top [MTR] at a level that will not result in reduction in work effort. Thirty to fifty percent is a reasonable range that will limit disincentives to work.[300]

It is also argued that there are a number of reasons for lowering MTRs to produce an increase in tax revenue[301], which include the following two.

The first is that the level of economic activity is greater because people have a higher disposable income as a result of tax-rate reduction.[302] Consequently, the government can impose higher taxes.

The second is based on the labour-supply effect. There is an argument referred to in Dilnot and Kell that "lower [MTRs] provide the incentive for people to work harder and generally encourage enterprise in the economy, thus boosting output and hence tax revenues."[303] There is also an argument referred to in Kay and King that reducing the MTR on the rich to zero could increase tax revenue.[304] Such an argument is based on the principle of neutrality as follows:

> "[Tax] revenue depends on [ATRs] but disincentives on [MTRs]. If we lower the [MTR] on the richest man, we reduce disincentive effects on him without reducing the amount of tax that he (or anyone else) pays. So if these disincentives are of any significance, earnings will increase and so will tax revenue."[305]

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[298] Messere, op.cit.(note240), p.249

[299] James and Nobes, op.cit.(note5), p.56; Kay and King, op.cit.(note60), p.39; and Andrew Dilnot and Michael Kell, "Top-Rate Tax Cuts and Incentives: Some Empirical Evidence", Fiscal Studies, Volume 9, Number 4, November 1988, 72.

[300] The World Bank, op.cit.(note112), p.43

[301] Brown and Sandford, op.cit.(note287), p.214

[302] Dilnot and Kell, op.cit.(note299), p.71

[303] ibid.p.71

[304] Kay and King, op.cit.(note60), p.37

[305] ibid.p.37

The argument that Kay and King refer to may be correct in theory. This is because the 0% MTR on the rich would not interfere with their choices between untaxed and taxed work because it allows them to keep the full return from extra work. This reason is adapted from Kay and King writing that "we would obtain more tax revenue if we retained some incentives by allowing [the rich] to keep part of their earnings for themselves."[306]

However, Brown points out that "if reductions in [tax rates] do not affect labour supply, then there can be no revenue-increasing effect from increased labour supply."[307] Therefore, despite a reduction in the top rate to 30-50% or 0%, tax revenue might not be increased if, in practice, such reduction did not influence taxpayers' decisions to do more paid work.

Slemrod and Bakija further argue that a reduction in MTRs on high-income taxpayers would help "the rest of the population."[308] Their argument is on the grounds that:

> "Reduced tax rates on high-income people, combined with greater incentives for saving, will lead to a larger and higher-quality capital stock. This, in turn, would give workers better 'tools' to work with, increasing their productivity and raising their wages."[309]

This argument implies that a reduction in MTRs on high-income earners could help increase tax revenue. This is because the more the workers earn as a result of higher investment by high-income groups, the more income tax the government can impose. However, this assumption relies on the fact that reduced MTRs on high-income earners do encourage them to invest their higher after-tax income on labour market activities.

Many countries have reduced MTRs to reduce the disincentive effect, particularly the top rates. The aim of the top-rate reduction which is part of "the world – wide tax reform" starting in the late 1970s was "the desire to make the tax system as neutral as possible, to minimize the effect of tax on economic decision-

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306 ibid.p.37
307 Brown, op.cit.(note290), p.102
308 Slemrod and Bakija, op.cit.(note63), p.120
309 ibid.p.120

making."[310] The major tax reforms in the UK to reduce the disincentive effect of high MTRs took place in the years 1979 and 1988.

3.2.1.2 ATR and incentives to work

Many support the argument that the ATR is relevant to the incentive effect.[311] This argument may be correct in principle.

The ATR represents the proportion of an individual's income paid in tax. After being taxed, a taxpayer becomes poorer and cannot afford the goods and services he/she could afford before tax.[312] If the taxpayer wanted to maintain his/her standard of living at the same level as that before tax, he/she would have to work harder and longer and take less leisure.[313] Accordingly, the ATR encourages a taxpayer to seek and/or to do more paid work to recover his/her taxed earnings. Similarly, the ATR has the incentive/income effect, which does not result in deadweight loss.[314]

Some further argue that an increase in ATRs increases work incentives.[315] However, others argue that an increase in MTRs encourages people to do more paid work.[316] It is difficult to prefer the former argument to the latter. This is because an increase in either ATRs or MTRs may help increase work incentives. As analyzed in 2.2, one means to increase the level of ATRs is to increase MTRs. Therefore, high MTRs indirectly support incentives to work in addition to directly creating disincentives to work.

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[310] Brown and Sandford, op.cit.(note287), p.202

[311] James and Nobes, op.cit.(note5), p.51; Slemrod and Bakija, op.cit.(note63), p.104; and Kay and King, op.cit.(note60), p.26

[312] Trotman-Dickenson, op.cit.(note138), p.96, James and Nobes, op.cit.(note5), p.51; and Slemrod and Bakija, op.cit.(note63), p.104

[313] Kay and King, op.cit.(note60), p.26; Brown and Sandford, op.cit.(note295), p.414; and Slemrod and Bakija, op.cit.(note63), p.104

[314] IFS, op.cit.(note98), p.8, and James and Nobes, op.cit.(note5), p.51

[315] Graham C. Hockley, Public Finance: An introduction (London: Routledge & Kegan Paul, 1979)393

[316] The Commission on Taxation and Citizenship, op.cit.(note22), p.226

3.2.1.3 Unclear theory

It appears from the above that the progressive rate structure creates "the countervailing effects"[317] of the incentive and disincentive effects. The ideas behind the effects of the progressive rate structure on work decisions are therefore unclear. Brown and Sandford support the view that:

> "Economic theory does not provide a clear answer about whether an increase in income tax rates reduces the willingness to work and a reduction in income tax rates increases it."[318]

To clarify the theory, I pose the following questions.

(a) Is it acceptable by reason of the world-wide tax reform to reduce MTRs in order to reduce the disincentive effect?

(b) There have been continuous reductions in MTRs in many countries since the late 1970s. A further question is to what extent such reductions have increased work incentives.

(c) Have MTRs under the current Thai and UK tax-rate schedules been set optimally enough to distort as little as possible work incentives?

Due to the unclear theory, empirical analysis of the effects of the progressive rate structure on work decisions is required.[319]

3.2.1.4 Empirical studies on tax effects

A number of empirical studies have been carried out in the form of interview and questionnaire surveys in different countries (including the UK)[320] at different times, covering low- and high-income groups.[321] However, most empirical studies conclude that the net effect of income taxation (which is based on the progressive rate structure) on work decisions is very small, either in the direction of disincentive or incentive.[322] Likewise, progressive income taxation has not influenced the work

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[317] Slemrod and Bakija, op.cit.(note63), p.104

[318] Brown and Sandford, op.cit.(note286), p.204

[319] Sandford, op.cit.(note19), p.149; and OECD, Theoretical and Empirical Aspects of the Effects of Taxation on the Supply of Labour (Paris: OECD, 1975), 6 and 26.

[320] I have found no empirical study on this field conducted in Thailand.

[321] James and Nobes, op.cit.(note5), p.63; Sandford, op.cit.(note19), p.150; and OECD, op.cit.(note319), p.124

[322] James and Nobes, op.cit.(note5),p. 63; and Brown and Sandford, op.cit.(note295), p.414

behaviour of the majority of people surveyed.[323] It has only affected the decisions of a minority of people surveyed in terms of both disincentive and incentive effects.[324]

For example[325], Barlow, Brazer and Morgan carried out a survey of tax effects on the work behaviour of high earners in the US in 1964.[326] They interviewed 957 high-income individuals.[327] They found that only one-eighth of interviewees suffered a disincentive effect and reduced "their work effort as a result of progressive income tax."[328] They therefore concluded that:

> "It is clear that there are many more powerful motives affecting the working behaviour of high-income people than the [MTRs]. People are aware of taxes and do not enjoy paying them, but other considerations are far more important to them in deciding how long to work."[329]

Brown and Levin carried out a survey of tax effects on overtime by interviewing over 2000 weekly paid workers (low-income groups) in Britain in 1971.[330] Their survey found that about 74% of interviewees were unaffected by income tax on overtime hours.[331] Among the remaining interviewees, 15% experienced an incentive effect and worked more overtime; 11% suffered a disincentive effect and worked less overtime.[332] Their survey then suggests that "the aggregate effect of tax on overtime is small."[333]

There are four noteworthy points from empirical studies.

Firstly, there are both disincentive and incentive effects in practice. However, both effects on work decisions are rather limited.

Secondly, although the disincentive and incentive effects are small according to empirical evidence, the features of both effects in practice are similar to those in theoretical analysis. Disincentive effects take the forms of reduction in work effort, refusal of a new job or of promotion, and emigration.

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323 Sandford, op.cit.(note19), p.151
324 OECD, op.cit.(note319), p.50
325 More empirical studies on this issue can be found in **Appendix X to Chapter Two**.
326 James and Nobes, op.cit.(note5),p.62
327 ibid.p.62
328 ibid.p.62
329 ibid.p.62
330 Brown and Jackson, op.cit.(note2), p.332
331 ibid.p.332
332 ibid.p.332
333 James and Nobes, op.cit.(note5), p.63

Meanwhile, incentive effects take the forms of postponing retirement, working more overtime, or choosing professions with high earnings potential where the probability of being affected by progressive income taxation is highest.

Thirdly, empirical studies do not provide clear results of tax effects on work decisions because there are both disincentive and incentive effects. Dilnot agrees that "evidence on the relationship between tax rates and incentives to work is still somewhat confusing."[334]

Fourthly, the work decisions of the majority of both low- and high-income groups are in practice unaffected by progressive income taxation.

Following the conclusion of a study conducted by Barlow, Brazer and Morgan above, there are a number of possible factors influencing individuals' work decisions apart from progressive income taxation. Such factors include the nature of work, personal circumstances, the mechanism of the labour market, and financial considerations. (More detailed discussion on these factors can be found in **Appendix XI to Chapter Two**).

Other factors influencing the work decisions mentioned above tend to support empirical studies that the disincentive and incentive effects of progressive income taxation are weak in practice. Given this, the rationale of the world-wide tax reform (including the UK tax reform) to reduce high MTRs to reduce the disincentive effect is unacceptable. However, I have not yet concluded that the rationale of tax reform for such a purpose is unacceptable, because there are arguments in favour of a reduction in high MTRs to reduce the disincentive effect. Such arguments include:

(a) tax avoidance overrides tax effects on work decisions;

(b) there is some evidence of tax effects on work decisions; and

(c) empirical studies based upon survey research are defective.

(a) Tax avoidance

Prest points out that:

"[There] is no net effect of high [MTRs] on the amount of work done by the upper income groups. [This] is because avoiding action is taken by people to

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[334] Andrew Dilnot, "The Income Tax Rate Structure", Key Issues in Tax Reform, Cedric Sandford, ed. (Bath: Fiscal Publications, 1993), 19.

make sure that the actual [MTRs] applicable to them are less than the apparent ones."[335]

Prest's argument may be valid because high-income groups tend to avoid and evade income tax. A survey by Holland supports Prest's argument, i.e. "[there is] little evidence of taxation reducing or increasing productive work, but rather more evidence of taxation causing businessmen to devote time to minimising their corporate and personal tax liabilities."[336]

(b) Evidence of tax effects on work decisions

According to Lindbeck as referred to in Slemrod and Bakija,

> "[The explanation of tax effects on work supply decisions] cannot be dismissed with regard to high-tax Sweden, which has experienced a gradual decline in hours worked over the past two decades."[337]

Slemrod and Bakija comment that Lindbeck's evidence adds "uncertainty to the claim that labor supply effects are negligible, but certainly does not provide any decisive evidence against that conclusion."[338]

Another piece of evidence has been discovered by Sandford.[339] He carried out a survey of 100 executives in the UK in 1967.[340] About 63% of those surveyed believed that "the tax had a disincentive effect."[341] The reason why the majority of people surveyed had such a belief might result from the fact that around the period the survey took place, high MTRs stretched to 91.25% in the UK.[342]

As noted in 2.4.3, the top MTR on earned income used to reach 83% and on unearned income 98% in the UK in the late 1970s. Prest agrees that such rates "might have strong repercussions on incentives to work."[343] Whittington asserts that:

> "It does not require the sophisticated analysis of optimal tax theory to demonstrate that a MTR of 98% provides a strong disincentive for the taxpayer to make much effort to increase his income."[344]

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[335] Prest, op.cit.(note40), p.270
[336] Brown and Jackson, op.cit.(note2), p.336
[337] Slemrod and Bakija, op.cit.(note63), p.108
[338] ibid.p.108
[339] This study is referred to in Trotman-Dickenson. (Trotman-Dickenson, op.cit.(note138), p.102)
[340] ibid.p.102
[341] ibid.p.102
[342] Prest, op.cit.(note40), p.268
[343] ibid.p.269

Altogether, the disincentive effect might be important for people paying income tax at the MTR of 90% or more. However, this conclusion is inconsistent with the finding of Break's survey. In Break's survey, the majority of high-income groups interviewed did not suffer from a disincentive effect even though at the time of the survey, the top MTR on earned income reached 92.5%. It is possible that a very high MTR did not have this effect on people in Break's survey because such people, solicitors and accountants, knew a legal way to avoid tax.

Besides Lindbeck's and Sandford's evidence, there is a claim on the disincentive effect in Mr. Lawson's Budget speech of 1988. Mr. Lawson claimed that "excessive rates of income tax ...drive talent to more hospitable shores overseas."[345] However, this claim may be refuted by The Brain Drain – Report of the Working Group on Migration (Cmnd.3417, 1967), if the talent to which Mr. Lawson referred includes engineers, technologists and scientists. This report is referred to in Brown and Sandford as follows:

> "The brain drain – restricted in its terms of reference to qualified engineers, technologists and scientists. [The Report] found little evidence to support the fear that tax was a main cause [of brain drain], and stressed other factors, such as better research facilities abroad, in explaining the brain drain."[346]

If the talent to which Mr. Lawson referred includes those in other fields than the scientific, the question then arises whether high MTRs affect such people's decisions to emigrate. According to an empirical study by Fiegehen and Reddaway, progressive income taxation had minimal effects on the decisions of senior executives to emigrate and to refuse "to return from overseas postings."[347] Dilnot and Kell also argue that "in deciding whether or not to emigrate, differences in gross salary levels and working conditions are likely to be as important as [MTR]."[348] Therefore, Mr. Lawson's claim is indecisive evidence to support the disincentive effect of high MTRs.

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[344] Whittington, op.cit.(note53), p.160
[345] Brown and Sandford, op.cit.(note287), p.211
[346] ibid.p.211
[347] Kay and King, op.cit.(note60), p.34

(c) Flaw of survey research

There are certain causes for defectiveness of empirical studies based upon survey research, which include:

(i) the methodology of empirical studies and the questions used in the survey,

(ii) the limitation of the groups of people surveyed, and

(iii) the knowledge and attitude of people surveyed about progressive income taxation.

Flaw (i)

It is argued that interview surveys are not "a very satisfactory method of investigation: they can reveal attitudes to taxation, but these are not necessarily good indicators of what people actually do."[349] Besides survey research, empirical study can be conducted in the form of econometric analyses. The OECD notes that tax effects on work decisions are small according to empirical research including econometric analyses.[350] James and Nobes assert,

> "The overwhelming weight of econometric evidence paints a fairly clear picture and cannot be ignored. It appears that, for many individuals, taxation has little influence on labour market activity."[351]

The general results of survey research and of econometric analyses are very similar. Given this, the statement that interview surveys are not good indicators to suggest tax effects on people's work decisions is not strong. We can - with some exceptions - accept the results of survey research.

However, although the results of general survey research are likely to have authority, "the survey results will be of little value if the wrong questions are asked."[352] The wrong questions relating to MTRs and ATRs will probably receive unexpected answers,[353] as Brown and Jackson remark by comparing the questions used in the surveys by Fields and Stanbury and by Break:

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[348] Dilnot and Kell, op.cit.(note299), p.72
[349] Kay and King, op.cit.(note60), p.33
[350] OECD, op.cit.(note318), p.126
[351] James and Nobes, op.cit.(note5),p.60
[352] OECD, op.cit.(note319), p. 30
[353] Brown and Jackson, op.cit.(note2), p.334

"Fields and Stanbury asked questions 'relating to the incentive or disincentive effects on work effort of high [MTRs]', whereas Break had asked questions about 'tax influences' on work effort. A subtle point, but one wonders how the results would have been affected if Fields and Stanbury had substituted the word 'average' for 'marginal' or better still just left it out altogether. The words used imply bias because high [MTRs] are relevant to disincentive effects while the [ATR] is relevant to the incentive effect."[354]

As shown earlier, the results of surveys by Fields and Stanbury and by Break are generally similar, showing that a majority of those surveyed were unaffected by progressive income taxation. The results of both surveys are only slightly different. The controversial result is the number of those suffering a disincentive effect. The number in Fields and Stanbury's study is 6% higher than that in Break's study. However, the difference did not absolutely result from the different words used in each survey. One observes that the difference in the numbers of those suffering disincentive effects might result from "the long-continued high levels of income taxation or declines in the nonmonetary satisfactions received from work or both."[355] Therefore, an argument against survey research based on the use of different words is unlikely to refute the survey results as a whole.

Flaw (ii)

Sandford claims that each survey research effort has been confined to "a particular income range or a small occupational group, so that firm generalized conclusions cannot easily be drawn."[356] The OECD also supports the view that as a result of the limitation of the groups of people surveyed, "the survey results are obviously of limited value as far as predicting the effects of taxation on the whole force is concerned."[357]

However, although the confined populations in surveys cannot give replies which represent the results of tax effects on the whole labour force, their replies tend to produce the results which researchers want, i.e. whether progressive income taxation creates incentives or disincentives to work in practice. As we have seen,

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[354] ibid.p.334
[355] George F. Break, "The Incidence and Economic Effects of Taxation", The Economics of Public Finance (Washington, D.C.: The Brookings Institution, 1974), 184.
[356] Sandford, op.cit.(note19), p.150

business executives and professionals, and workers who can work overtime and are paid piece rates are often chosen in surveys because they are aware of how to vary their working behavior to bring about changes in actual tax rates. Therefore, the replies of these groups tend to produce the desired results, provided that they have had sufficient knowledge of income taxation.

Flaw (iii)

This flaw involves the knowledge and attitude of people surveyed about income taxation. The OECD points out that "if individuals are unaware of tax changes they will not respond to them." [358] Similarly, James and Nobes refer to Brown and Dawson's comments that:

> "Misconceptions of the tax system may also influence incentives. If people think that tax rates are higher or lower than they really are, then this in itself can affect their work effort."[359]

Thus, if the people surveyed have insufficient knowledge or misconceptions about income taxation, they cannot be expected to vary their working behavior according to changes in actual tax rates. However, the representatives of high-income groups surveyed, i.e. business executives and professionals, are accepted as having an accurate knowledge of the tax structure.[360] They are therefore expected to be responsive to tax changes and their replies are likely to be reliable. Therefore, an argument against research based on the knowledge of high-income groups surveyed about progressive income taxation is unlikely to deny the survey results as a whole.

Conversely, there is some evidence showing that the representatives of low-income groups surveyed had insufficient knowledge of progressive income taxation. Summer refers to a survey by Brown (1968) that:

> "None of the 179 wage earners knew his [MTR], which was typically overestimated; almost all the 53 salaries workers displayed the same bias towards exaggeration, and only three knew the correct figure."[361]

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[357] OECD, op.cit.(note319), p.123
[358] ibid.p.127
[359] James and Nobes, op.cit(note5), p.58
[360] OECD, op.cit.(note319), p.51
[361] Michael T. Summer, "Chapter 2 The Incentive Effects of Taxation", Public Sector Economics (London: Longman, 1983), 45.

Similar evidence appears in a survey for the British Royal Commission on the Taxation of Profit and Incomes (1952). The OECD refers to this survey claiming that "many of the workers in the sample were very ignorant about their tax position, and it was estimated that only 4% of the men knew in any detail how they were affected by income tax."[362] Trotman-Dickenson also comments that "very few of them (workers), it seems, have sufficient knowledge of the way that they are affected by the tax to be able to take that factor accurately into account in deciding upon behavior at work."[363] As stated earlier, the conclusion of this survey is that "there was no evidence that [the] productive effort [of these workers] was inhibited by the income tax."[364] It seems that the replies of these workers might be unreliable because of their insufficient knowledge of income taxation. Prest supports the view that:

> "Worker-attitude surveys simply cannot be reliable. People have an innate tendency to rationalize their answers to questions of this kind, and therefore no trust can be placed in their answers."[365]

However, the replies of these workers that income tax had no influence on their work decisions could result from their very low MTRs. Consequently, these workers might be unaware of tax considerations. As Prest notes,

> "By far the great majority of those interviewed in the Royal Commission Survey were in the income ranges below £10 a week and as a consequence, the [MTRs] payable were relatively low. It is not therefore really surprising that tax considerations were unimportant for people at these income levels."[366]

Regarding the knowledge of low-income groups surveyed, the following conclusions are made.

(a) If people were not knowledgeable about income taxation, their replies in surveys could be unreliable, causing a flaw in survey research.

(b) A very low tax rate might make people unaware of tax effects on their work decisions.

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[362] OECD, op.cit.(note319), p.35
[363] Trotman-Dickenson, op.cit.(note138), p.100
[364] Brown and Jackson, op.cit.(note2), p.331
[365] Prest, op.cit.(note40), p.269
[366] ibid.p.270

Additionally, the attitude of people surveyed might cause flaws in survey research. As James and Nobes note,

> "Individuals may not give accurate replies in response to a survey for a number of reasons. The respondents may not be aware of the real answers; or there may be other reasons why they wish to give an impression of their behavior which is not wholly consistent with the facts."[367]

However, this point is unlikely to deny the main results of survey research for the following reasons.

(a) If the people surveyed are expected to have attitudes, such as James and Nobes' s claim above, their replies could be diversified because people simply have different views.

(b) However, it appears that "there are so many similarities in the findings of [survey research]"[368] although survey studies are carried out at different times in different countries covering both low- and high-income groups of taxpayers.[369] This is because the majority of people surveyed in the examples given above had the same view that income taxation had little influence on their work decisions.

Altogether, the main finding of empirical studies is that progressive income taxation has little disincentive or incentive effect on work decisions in practice. This finding is reinforced by factors that affect individuals' work decisions other than income taxation. However, this finding may be weakened by the following arguments.

(a) That the majority of high-income groups do not suffer the disincentive effect of high MTRs partly results from tax avoidance and evasion.
(b) A very high MTR would have a disincentive effect on high-income groups if they did not have a chance to avoid or evade tax.
(c) If people are not knowledgeable about income taxation, their replies in surveys could be unreliable, causing flaws in survey research.
(d) A very low MTR might make people unaware of tax effects on their work decisions.

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[367] James and Nobes, op.cit.(note5), p.62
[368] OECD, op.cit.(note319), p.50
[369] ibid.p.50

Although the above arguments may cast doubt on the finding of empirical studies, there is no argument against other factors that influence individuals' work decisions, e.g. the nature of the work. Thus, the finding of empirical studies cannot be absolutely denied.

Given this, it is more difficult to answer the question of whether the rationale of the world–wide tax reform to reduce high MTRs to reduce the disincentive effect is acceptable or not. It is further necessary to consider whether tax-rate reduction has led to an increase in work effort. Empirical evidence is required in addition to theoretical analysis.

3.2.1.5 Empirical studies on tax-rate reduction

A reduction in high MTRs on labour income is supposed to increase work incentives and tax revenue. However, this supposition can be denied if we consider the effect of tax-rate reduction in the direction of income effect.

In terms of the income effect, lower MTRs could reduce work incentives because lower MTRs make people better-off; therefore, people might not want to work harder because the higher disposable income after tax could maintain their standard of living.[370]

Theoretical analysis thus seems give unclear answer about whether tax-rate reduction increases or reduces work incentives. Empirical studies in this area are necessary. The major UK tax reforms to reduce the disincentive effect of high MTRs took place in the 1979 and 1988 Budgets. Although there were predictions that tax-rate reduction could significantly increase work incentives and tax revenue, empirical studies in the UK[371] suggest the opposite.

As a result of the 1979 Budget, the basic rate of income tax came down from 33% to 30%[372]; and the highest MTR on earned income was cut from 83% to 60% and on unearned income from 98% to 75%.[373] In Sir Geoffrey Howe's Budget speech of 1979, he claimed that tax-rate reduction at all levels "is the only way we

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[370] Dilnot and Kell, op.cit.(note299), p.72; and Brown and Sandford, op.cit.(note287), p.205

[371] I have found no empirical evidence on this area in Thailand.

[372] Brown, op.cit.(note290), p.96

[373] Whittington, op.cit.(note53), p.160

can restore incentives and make it worthwhile to work."[374] Whittington supports this Budget. He claims that tax-rate reduction would "alleviate the problem of high [MTRs] on high incomes", in particular the problem of a strong disincentive.[375]

Similarly to the 1979 Budget, the 1988 Budget further reduced MTRs. As a result of this Budget, the basic rate came down to 25%.[376] Besides, it swept away "the four top rates" cutting the highest MTR on both earned and unearned income to 40%.[377] Mr. Lawson claimed in his 1988 Budget speech that "a reduction in the top rates of income tax can, over time, result in a higher, not a lower yield to the Exchequer."[378]

Brown refers to Minford (1988) and Lindsey (1987) who support Mr. Lawson's claim that "the higher-rate tax cuts will lead to a substantial increase in work incentives", and "increase tax receipts."[379]

According to Dilnot and Kell, the evidence of revenue increase following tax-rate reduction from 83% to 60% in 1979 and the abolition of the investment income surcharge in 1984 is that "the share of total tax revenue paid by the richest 5 per cent of taxpayers increased between 1978/79 and 1985/86."[380] Ormrod (1988) as referred to in Dilnot and Kell argues that:

> "One may expect the greatest motivation to be given to the top 1% who have received the greatest fall in [MTRs]. They are also sometimes put forward by supply-siders as the group most able and willing to increase their income. Yet it is this group which has increased its proportionate share the least of the top 5 percentile groups."[381]

It can be inferred from evidence and Ormrod's argument that tax-rate reduction caused higher-rate taxpayers to do more paid work and to pay more income tax, resulting in revenue increase.

However, there is empirical evidence that the effects of tax-rate reduction on (a) work incentives and (b) revenue increase were minimal. Regarding the reduction

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374 Brown, op.cit.(note290), p.96
375 Whittington, op.cit.(note53), p.160
376 Brown and Sandford, op.cit.(note295), p.415
377 ibid.p.415
378 Brown, op.cit.(note290), p.93
379 ibid.p.93
380 Dilnot and Kell, op.cit.(note299), p.72
381 ibid.pp.72-73

in the basic rate to 25% in 1988, Brown notes, "there is little evidence to suggest that there will be significant changes in short-run labour supply as a result of the cut in the basic rate of tax."[382] He also finds evidence about the effect of the reduction in the top rate to 40% in 1988 as follows:

> "Evidence about the labour supply effects of higher tax rates is weaker but most evidence suggests that the cuts in the higher rates of tax will not increase work incentives."[383]

Empirical study by Dilnot and Kell supports the evidence as claimed by Brown.[384] According to Dilnot and Kell's research conducted in 1988 on the effects of reductions in the top rate between 1978 (98%) and 1988 (40%) (referred to in Nightingale), "there was a small incentive in cutting the [MTRs]."[385] This study also argues against evidence which shows that revenue increase between 1978/79 and 1985/8 came about because the tax-rate reduction in 1979 and the abolition of the investment income surcharge in 1984 had a supply side effect on higher-rate taxpayers. The suggestion from their study (referred to in Disney) is that revenue increase over that period resulted from "changes in employment, inflation, and income components."[386]

There are noteworthy points from empirical studies.

Firstly, tax-rate reduction has little impact on work incentives.

Secondly, an increase in work incentives probably results from other factors, which include an increase in consumer goods[387], pressure of work from the demand[388], and a desire to extend work experience.[389]

Thirdly, although there were revenue increases in subsequent years after the reduction in MTRs, the reasons for such increases were other than that lower MTRs stimulated work effort and enterprise.

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[382] Brown, op.cit.(note290), p.95
[383] ibid.p.106
[384] There are other three empirical studies on this issue, which can be found in **Appendix XII to Chapter Two.**
[385] Nightingale, op.cit.(note65), p.13
[386] Richard Disney, IMF Working Paper: The Impact of Tax and Welfare Policies on Employment and Unemployment in OECD Countries (Washington D.C.: IMF, 2000), 21.
[387] OECD, op.cit.(note319), p.39
[388] Brown, op.cit.(note290), p.106
[389] Brown and Sandford, op.cit.(note287), p.211

My research so far has found that there is disagreement between theoretical and empirical analysis. The former suggests that tax-rate reduction can significantly increase work incentives and tax revenue, but the latter suggests the opposite. I support the view that tax-rate reduction has little impact on work incentives because of evidence from the empirical studies above. Besides the UK evidence, there is no strong evidence that lower MTRs increase work incentives in the US.[390] Furthermore, there is nothing to suggest that it is not other factors which influence individuals' work behaviour. The OECD suggests that "it [is] impossible to separate out the effects of tax changes from the effects of other variables determining work effort."[391]

I also support the view that tax-rate reduction could not significantly increase tax revenue on labour supply grounds. Similarly, I disagree with the theoretical analysis which claim that "a reduction in tax rates on labour income could increase labour supply and through this route increase tax revenue."[392] This disagreement comes from evidence in the empirical studies above. Besides the UK evidence, the US evidence shows that the tax rate cuts of 1981 did not generate more revenue.[393]

However, there is evidence supporting the view that tax-rate reduction increases tax revenue on labour supply grounds, as referred to in Dilnot and Kell. Such evidence is the increased share of tax liability of higher-rate taxpayers between 1978/79 and 1985/86. However, it is indecisive because there are stronger factors to support such increase than labour supply. As analyzed in 2.4.4.1, the increased share of tax liability of higher-rate taxpayers partly results from discouragement of tax avoidance and evasion and the fall in the high-income level subject to the top rate.

3.2.1.6 Changes in the tax-rate schedule and OSMTRS

At page 85, I pose three questions. The following are my answers to the questions.

(a) The rationale of tax reform to reduce high MTRs (except for a very high MTRs of around 90% or more) to reduce the disincentive effect seems unacceptable.

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390 Slemrod and Bakija, op.cit.(note63), p.124
391 OECD, op.cit.(note319), p.38
392 Brown, op.cit.(note290), p.101
393 Slemrod and Bakija, op.cit.(note63), pp.124-125

(b) A reduction in MTRs has not in practice significantly increased work incentives.

(c) MTRs under the current Thai and UK tax-rate schedules have been set optimally to prevent probable tax effects on work decisions.

The following are the chief reasons for these three answers.

The main finding of empirical studies is that tax effects on work decisions are very small in practice. Arguments against empirical studies are not strong enough absolutely to dismiss this finding. Furthermore, there is no argument or evidence against other factors influencing work decisions than progressive income taxation and tax-rate reduction. Moreover, empirical evidence and analysis are more decisive than theoretical analysis to support the view that tax-rate reduction cannot significantly increase work incentives and tax revenue. (This is the rationale for answer (b)). For these reasons, the argument for tax reform to reduce MTRs to reduce the disincentive effect seems unacceptable. (This is a reason for answer (a)).

However, very high MTRs of around 90% or more would create disincentives to work when high-income taxpayers have no chance to avoid and evade tax. As we have seen, MTRs at all income levels under the current Thai and UK tax-rate schedules have now been reduced. Therefore, MTRs under both schedules have been set optimally not only to discourage tax avoidance and evasion but also to prevent probable disincentives to work. (This is a reason for answer (c)). Consequently, MTRs under both schedules are likely to be set in agreement with part of OSMTRS, which requires a reduction in the disincentive effect.

3.2.2 Effects on saving and investment

It is believed that tax considerations have affected taxpayers' choice of savings instruments.[394] Furthermore, it is doubtful whether taxation may affect the level of household savings.[395] Moreover, it is supposed that taxation will affect returns on risk-taking and therefore the level of investment.[396]

The notion behind the suppositions above is that income taxation based on the progressive rate structure creates disincentives to save and invest. It is therefore

[394] Messere, op.cit.(note240), p.137
[395] ibid.p.137

supposed that lower MTRs on income from saving and investment would generate incentives to save and invest. However, this supposition may be dismissed because the progressive rate structure can have an incentive effect in addition to a disincentive effect. Therefore, I pose the following questions.

(1) In which direction does the progressive rate structure affect savings and investment rates in practice (a negative or positive direction)?

(2) Is it necessary to reduce MTRs on income from saving and investment, particularly interest and dividend income, to boost savings and investment rates?

(3) Have MTRs on income from saving and investment under the current Thai and UK tax-rate schedules been optimally set?

3.2.2.1 Negative effect on saving and investment

It is believed that the progressive rate structure could contribute to low savings and investment rates.[397] As we shall see below, this belief is plausible because (a) an ATR and a MTR reduce a taxpayer's ability to save and invest, and (b) a MTR reduces incentives to save and invest.

3.2.2.1.1 Tax rates and an ability to save and invest

Dalton claims that "ability to save is reduced by all taxes on persons who have any margin of income, out of which saving is possible."[398] He further claims that "ability to invest depends on the resources available for investment; it is clear that these are reduced by taxation."[399]

Both claims are correct. If the MTR on earned income were high or very high, the disposable income at a margin after tax would be small or very small. The disposable income is supposed to be further saved and invested.[400] The less the disposable income, the less a taxpayer can further save and invest.

Likewise, the ability to save and invest is reduced when we take a high ATR into account. Throop Smith remarks that "the greater the total tax burden, the greater

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396 James and Nobes, op.cit.(note5), p.69
397 ibid.p.72
398 Dalton, op.cit.(note30), p.74
399 ibid.p.74
400 James and Nobes, op.cit.(note5), p.67

the likelihood that taxation will unduly discourage... savings and investments."[401] The ATR represents the total tax burden on a taxpayer, affecting his/her disposable income after tax. Therefore, the higher the ATR, the less the disposable income a taxpayer has to further save and invest.

3.2.2.1.2 Tax rates and disincentives to save and invest

Reductions in savings and investment rates may also result from the disincentive effect of MTRs. There are two arguments for this, namely

(a) MTRs on income from saving and investment contribute to double taxation; and

(b) high MTRs on income from saving and investment reduce marginal after-tax returns on savings and investments.

(a) Double taxation

It is argued that savings are taxed twice. They are first levied when a taxpayer earns income from work. They are levied again on returns (i.e. interest or dividend income) on savings or investment made from earned income.[402] Because of this, it seems that income tax "differentiates against saving"[403] and investment. Income tax is then thought to produce disincentives to save and invest.[404]

However, this view on double taxation is not decisive enough to conclude that income tax reduces incentives to save and invest because interest or dividend income that is taxed is a new sum derived from savings or investments. It is therefore justifiable to tax interest or dividend, but unjustifiable to tax savings or investments again.

(b) High MTRs and disincentive

According to Schnitzer,

"[High MTRs] may well have an injurious effect on savings and on the supply of venture capital. Moreover, the effect of high [MTRs] may well discourage entry into high-risk activities."[405]

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401 Dan Throop Smith, Encyclopedia of Economics, Douglas Greenwal, ed. (New York: McGraw-Hill Book, 1982), 995.
402 OECD, Taxation and Household Saving (Paris: OECD, 1994), 14.
403 Silverman, op.cit.(note43), p.166
404 OECD, op.cit.(note402), p.14
405 Schnitzer, op.cit.(note22), p.7

The above argument may be correct because a high MTR, especially at 50% or more[406], causes considerable reductions in marginal after-tax returns on savings and investments. Additionally, a high MTR contributes to a considerable reduction in the overall after-tax returns on savings and investments because it helps increase the ATR on such returns. Given this, a high MTR has a disincentive effect.

The disincentive effect of high MTRs on saving and investment causes a taxpayer to consider substituting present consumption for saving or investing for future consumption (or "the substitution effect").[407]

The disincentive/substitution effect takes place since low future returns on savings or investments would raise "the price of future consumption"[408], and then a taxpayer might decide to spend his/her money now rather than to save or invest. In addition, the price of future consumption would be higher if the rate of inflation were also taken into account.[409]

The disincentive/substitution effect possibly causes a taxpayer to substitute present consumption for saving or investing for future consumption. Consequently, such an effect would lower savings and investment rates. Mankiw supports the view that "low saving rate... is at least attributable to tax laws [on high MTRs] that discourage saving."[410]

Low savings and investment rates caused by the disincentive/substitution effect are deadweight loss. This is because the less the people save and invest, the less tax the government can claim on returns on savings and investments.

Altogether, it seems that the progressive rate structure creates a negative effect on savings and investment rates. However, I cannot conclude this point here until arguments on the positive effect of the progressive rate structure on savings and investment rates have been examined.

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[406] Tanzi and Schuknecht, op.cit.(note190), p.60

[407] OECD, op.cit.(note402), p.14; and Anthony B. Atkinson and Joseph E. Stiglitz, Lectures on Public Economics (Berkshire: McGraw-Hill Book, 1980), 94-95.

[408] Atkinson and Stiglitz, op.cit.(note407), pp.94-95

[409] **Example 2.9** in **Appendix XIII to Chapter Two** will help clarify this point.

[410] Mankiw, op.cit.(note36), p.552

3.2.2.2 Positive effect on saving and investment

Besides the disincentive effect, the progressive rate structure has an incentive effect on saving and investment. This effect is thought to result from a reduction in the overall after-tax returns on savings and investments due to a high ATR.

A reduction in returns on savings resulting from a high ATR might encourage a taxpayer to save more.[411] The main reasons for greater saving include:

(a) "to maintain the absolute level of the returns on the stock of savings held"[412];

(b) to secure a taxpayer's future[413]; or

(c) to secure the future of a taxpayer's dependents if he/she should die early.[414]

As regards investment, a reduction in income from investment as a result of a high ATR might stimulate a taxpayer to invest more.[415] A taxpayer could increase income from investment either by "[increasing] his investment or by transferring his investment to projects or shares which offer a higher return but are more risky."[416] In addition, Silverman has found some support for the notion of the incentive effect as follows:

> "Some of [writers] contend that heavy taxation may in some cases have the reverse effect of stimulating the payer to further effort in order to maintain his accustomed standard of living."[417]

Altogether, it seems that the incentive effect of a high ATR boost savings and investment rates.

3.2.2.3 Unclear theory

The theoretical studies have established that besides reducing the taxpayer's physical ability to save and invest, the progressive rate structure creates opposing psychological effects, i.e. negative/disincentive and positive/incentive effects on

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[411] Silverman, op.cit.(note43), p.165
[412] OECD, op.cit.(note402), p.14
[413] Silverman, op.cit.(note43), p.173
[414] ibid.p.165
[415] James and Nobes, op.cit.(note5), p.62
[416] ibid.pp. 69-70
[417] Silverman, op.cit.(note43), pp.175-176

saving and investment. This ambiguity of these psychological effects makes it impossible to answer the question regarding the direction of the effect of the progressive rate structure.

Arguments and empirical evidence supporting or opposing the negative or positive effect of the progressive rate structure on savings and investment rates will further be investigated.

3.2.2.4 Arguments and evidence supporting the negative effect

One of the main arguments and evidence to support the claim of negative effect is the reduction in a taxpayer's physical ability to save and invest. When the psychological effects are taken into consideration, four arguments and evidence have been found to confirm the negative influence:

(a) tax avoidance and evasion,
(b) the disincentive effect of a very high MTR,
(c) the advantage of tax-rate reduction, and
(d) the comparative effect of high MTRs on low- and high-income groups.

3.2.2.4.1 Tax avoidance and evasion

The negative effect of the progressive rate structure on saving and investment is also seen in tax avoidance or evasion tactics. If tax evasion cannot be done, tax avoidance may be undertaken instead in the following forms.

A taxpayer may decide not to save money in a form that is subject to a high MTR, but may seek another untaxed or more lightly taxed form of saving.

As regards investment, to avoid high MTRs on higher returns, a taxpayer may choose "transfer of the function to smaller businesses"[418], or to distribute "investments that yield less investment income."[419]

3.2.2.4.2 Effects of very high MTR

It is argued that a very high rate of 98% in the UK in the late 1970s inevitably affected people's economic behaviour.[420] This UK experience supports the view that

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418 Silverman, op.cit.(note43), p.178
419 Kaldor, op.cit.(note54), p.111

a very high MTR has a negative effect on saving and investment because it is likely to encourage tax avoidance and evasion.

Additionally, a very high MTR enhances disincentives to save and invest because it produces very low marginal returns on savings and investments. Furthermore, it leads to a very great reduction in the overall after-tax returns on savings and investments since it contributes to a very high ATR.

3.2.2.4.3 Advantage of tax-rate reduction

It is argued that a reduction in high MTRs on returns on savings and investments would help boost savings and investment rates.[421] There are two reasons for this.

Firstly, tax-rate reduction would reduce incentives to avoid or evade tax imposed on returns on savings and investments.[422]

Secondly, lower MTRs are believed to reduce distortions in incentives to save and invest[423], which would increase incentives to save and invest.[424] Likewise, higher marginal returns due to lower MTRs would encourage more saving and investment.[425] Consequently, tax-rate reduction causes people to save and invest more because they want to take advantage of the greater returns on savings and investment.[426]

3.2.2.4.4 Comparative effect on low- and high-income groups

Silverman argues that "the effect of a high income tax on the savings of individuals naturally varies with the amount of the respective incomes."[427] Comparing lower- and higher-income groups, Silverman argues that the latter appear to be more discouraged from saving than the former.[428]

Silverman' s argument may be correct. This is because the higher the MTR on interest income, the less people desire to save. Conversely, Silverman argues that

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420 Whittington, op.cit.(note53), p.160
421 Slemrod and Bakija, op.cit.(note63), p.120
422 Brown and Sandford, op.cit.(note286), p.202
423 ibid.p.202
424 ibid.p.202
425 Dalton, op.cit.(note30), p.75
426 Slemrod and Bakija, op.cit.(note63), p.110; and Messere, op.cit.(note240), p.139
427 Silverman, op.cit.(note43), p.168
428 ibid.p.172

low- and moderate-earners are less discouraged from saving due to MTRs than high-income earners. According to Silverman, people in the lower income groups are more likely to diminish their everyday consumption than to cut down on their savings despite curtailment of the return on savings due to MTRs.[429] The reason for this is that:

> "...in these classes, the incentive to provide for old age and for dependants is very strong. They are more concerned with making their position secure than with obtaining the maximum immediate return from their wealth."[430]

Additionally, Silverman argues that higher earners are discouraged from investment due to MTRs more than lower earners.[431] His reason is that "[those in the higher income classes] look to their investments not merely to give them security but also to enrich them in the near future."[432] High MTRs considerably reduce the marginal returns on investments; therefore, "those with large incomes might aver that the heavy exactions [due to high rates] make the additional [investment] seem hardly worth while."[433] Conversely, when lower earners are taken into account, Silverman states as follows:

> "It has to be recognised that the majority of the smaller taxpayers have little chance of adjusting their activities according to the rates of tax, and where they are in a position to do so the benefit they would secure would be very small."[434]

The comparisons above appear to support the view that a high MTR has a negative effect on the saving and investment decisions of high-income earners.

3.2.2.5 Arguments and evidence supporting the positive effect

There are two main arguments and evidence supporting the view that the progressive rate structure has a positive effect on saving and investment, namely (a) the disadvantage of tax-rate reduction, and (b) the existence of other factors influencing individuals' saving and investment decisions.

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[429] ibid.p.168
[430] ibid.p.168
[431] ibid.pp.169, 176
[432] ibid.p.169
[433] ibid.p.176
[434] ibid.p.176

3.2.2.5.1 Disadvantage of tax-rate reduction

As discussed in 3.2.2.4.3, reduction in a high MTR would increase incentives to save and invest. However, there is an argument against this that a lower MTR could encourage people to save and invest less than before.

An increase in a MTR increases an ATR. Therefore, a lower MTR reduces the total tax burden. It is argued that higher after-tax returns on savings or investments, due to tax-rate reduction, will encourage people to save or invest less than before for future consumption.[435] Slemrod and Bakija give an example to illustrate this point.

> "If you have a fixed goal for your level of retirement income, or a fixed amount you need to save up to pay for your child's college education, a higher reward to saving makes it easier to achieve that goal."[436]

It is also argued that a higher after-tax return due to a lower MTR will encourage people to spend more money now on "an improved standard of living."[437] Therefore, it seems that tax-rate reduction reduces incentives to save or invest.

3.2.2.5.2 Other factors influencing saving and investment decisions

There is a hypothesis that the effect of income tax on interest income is "the same as a reduction in the pre-tax interest rate."[438] It is further assumed that "the response of savings to taxation is inferred – indirectly – from the interest elasticity of savings."[439] It is then assumed that "changes in the rate of interest have only a moderate influence on the propensity to save out of a given income; it was an obvious corollary to this argument that the reduction in the net return from savings, due to income tax, is not likely to have a quantitatively important influence either."[440]

The above assumption therefore opposes the notion of the disincentive effect of a high MTR on saving. Additionally, empirical studies, as discussed below, suggest that the relationship between the savings rate and a higher after-tax rate of

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[435] Slemrod and Bakija, op.cit.(note63), p.110
[436] ibid.p.110
[437] Dalton, op.cit.(note30), p.75
[438] Atkinson and Stiglitz, op.cit.(note407), p.91
[439] ibid.p.91
[440] Kaldor, op.cit.(note54), p.91

return on savings is small. The empirical evidence thus opposes the notion of the incentive effect of tax-rate reduction on savings.

Although a study by Friend and Hasbrouck in 1983, based on a review of a number of previous studies, found that the response of the savings rate to the rate of interest was substantially positive,[441] "their empirical evidence failed to support the view that higher after-tax rates of return increased saving"[442], as concluded by James and Nobes. This finding is supported by other empirical studies referred to by Slemrod and Bakija who state that "any response of the saving rate to the incentive effect of a higher after-tax rate of return is likely to be fairly small."[443]

From the above, the response of the saving rate to a lower or higher after-tax rate of return, due to a high or low MTR, is small. This may be true because the possible cause of the phenomenon is that there are factors influencing individuals' saving decisions other than the MTR on the return on savings. Messere supports the view that "...the savings behaviour of households is also influenced by a number of factors having little or nothing to do with taxation."[444]

Other factors influencing the savings rate can be divided into two groups, namely (a) factors influencing a decline in saving and (b) those influencing an increase in saving.

Factors under (a) include demographic shift, inflation, interest rates, financial liberalisation, and social welfare programmes. These undermine the argument that a high MTR causes a fall in the saving rate. (More detailed discussion on these factors can be found in **Appendix XIV to Chapter Two**).

Factors under (b) include having some target for future consumption, deflation, decline in property prices, a big increase in government borrowing, inflation, and interest rates. These undermine the role of tax-rate reduction in the rise in the saving rate. (More detailed discussion on these factors can be found in **Appendix XIV to Chapter Two**).

As with saving, there are other factors influencing investment decisions, which probably undermine the role of the MTR in the rise or fall in the investment

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441 James and Nobes, op.cit.(note5), p.68
442 ibid.p.68
443 Slemrod and Bakija, op.cit.(note63), p.112
444 Messere, op.cit.(note240), p.137

rate. Silverman discovers that "the general conditions of industry and trade" or "the relative falling-off in trade" could influence decisions to invest more than tax rates could.[445] "The desire to make a big gain"[446] could also effect a rise in investment.

3.2.2.6 Evaluating the effects of the progressive rate structure on saving and investment

My research so far agrees with the argument that "estimating [the effect of] the tax rate on the return to saving is a particularly vexing problem."[447] As we have seen, assessment of the effect of the progressive rate structure on the return on investment is also a vexing problem. Despite the problem, this research can draw conclusions from the premises as discussed above. Such conclusions will be in the form of answers to the questions posed at page 100.

Regarding the first question of the direction of the effects of the progressive rate structure on savings and investment rates, this research concludes that the progressive rate structure could have a negative effect on savings and investment rates, leading to a decline in both.

Firstly, a high MTR and a high ATR on earned income reduce the ability to save and invest.

Secondly, despite the fact that there are a number of factors other than taxation influencing decisions to save and invest, this does not completely dismiss the negative effect of the progressive rate structure on savings and investment rates. This is because of two psychological effects: (a) the disincentive effects on saving and investment caused by very high MTRs on returns on savings and investments, and (b) incentives to avoid or evade tax due to high MTRs on returns on savings and investments.

Except for the two psychological effects above, the progressive rate structure is assumed either to discourage or to encourage saving and investment. Discouragement of saving and investment arises from the premise that high MTRs on income from saving and investment reduce the marginal returns on savings and investments. Encouragement of saving and investment arises from the premise that

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[445] Silverman, op.cit.(note43), pp.173 and 179
[446] Messere, op.cit.(note240), p.137

high ATRs resulting from an increase in MTRs on income from saving and investment reduce the overall returns on savings and investments. Given this, the progressive rate structure could have influences on either a rise or a fall in saving and investment rates.

Although the progressive rate structure could create these opposing effects, this research concludes that the disincentive effect is likely to outweigh the incentive effect. This is because of:

(a) the improbability of the incentive effect, and

(b) the likelihood of the disincentive effect in practice.

These reasons obtain when both effects on each particular group of people are weighed.

According to Silverman, the effect of the progressive rate structure on the savings and investments of individuals varies with "the character" and "the amount of the respective incomes."[448] As stated earlier, he further argues that low and moderate earners "are more concerned with making their position secure than with obtaining the maximum immediate return from their wealth."[449] Silverman's view that low and moderate earners would be encouraged by the reduction in overall returns on savings and investments due to high ATRs to save and invest more than before is convincing.

Nevertheless, in practice, most low and moderate earners would not be able to save and invest more if the limit of their earning opportunity did not allow them to afford greater saving and investment. Apart from this, in cases where low or moderate earners could afford it, the benefit that they would gain from greater saving and investment is not great. This is not only because of limits on their additional earnings but also because their incomes from greater saving and investment may be subject to higher MTRs. Therefore, I agree with Silverman when he suggests that to secure their livelihood and/or the livelihood of their dependents in the future, low and moderate earners tend to cut down their everyday expenditure rather than cut down their savings and investments.[450]

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[447] Slemrod and Bakija, op.cit.(note63), p.111
[448] Silverman, op.cit.(note43), pp.168, 179-180
[449] ibid.p.168
[450] ibid.pp.165, 168

The above discussion suggests that generally, there is likely to be no incentive effect from the progressive rate structure on the decisions of low and moderate earners to save and invest more.

Conversely, according to Silverman, high earners are concerned with "the maximum immediate return" from their savings and enrichment from their investments in addition to their security.[451] As referred to earlier, Silverman argues that high earners would be discouraged from saving and investment by the reduction in returns on savings and investments due to high MTRs. Silverman's idea is convincing. This is because the proportions of after-tax returns are smaller and much smaller when the returns on savings and investments are higher and much higher. Therefore, in practice there is likely to be a disincentive effect on high earners.

The likelihood of a disincentive effect on the saving and investment decisions of wealthy people would significantly affect efficiency of taxation and the national economy as a whole. Perception of the negative effect on the national economy is derived from Silverman, who writes that "as is well known, the bulk of the national savings comes from the comparatively well-to-do classes."[452] Similarly, "a larger and higher-quality capital stock" comes from the savings of the wealthy.[453] If there were a lower level of national savings due to curtailment of saving by the wealthy, economic growth would be affected. This is because a low level of national savings restricts the level of investment. Additionally, if there were a low level of investment due to curtailment of investment by the wealthy, economic growth would also be affected. This is because a low level of investment restricts the level of production of any country.

My research so far suggests, in answer to the first question, that the progressive rate structure is more likely to create negative than positive effects on saving and investment rates. Despite this conclusion, a reduction in MTRs for the purpose of boosting saving and investment rates is required with restrictions. This is an answer to the second question whether tax-rate reduction in income from saving and investment is needed to boost savings and investment rates.

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451 ibid.pp.168, 169
452 ibid.p.169
453 Slemrod and Bakija, op.cit.(note63), p.120

However, my research would suggest that MTRs on returns on savings and investments should not be excessively lowered, particularly on interest and dividend incomes for high earners. This is based on seven premises.

Firstly, the psychological effects of the progressive rate structure are not the only factor influencing a decline in saving and investment rates. As discussed earlier, there are other factors influencing this. If the psychological effects were the only factor determining the decline in savings and investment rates, there would be no objection to the imposition of excessively low MTRs on returns on savings and investments.

Secondly, tax-rate reduction is not the only factor to boost saving and investment rates. As discussed earlier, there are other factors involved. If tax-rate reduction were the only factor determining the rise in savings and investment rates, there would be no objection to the imposition of excessively low MTRs on returns on savings and investments.

Thirdly, as discussed earlier, there is empirical evidence showing that the relationship between a rise in the saving rate and a higher after-tax rate of return on savings is fairly small. If the response of the saving rate to a higher after-tax rate of return on savings, due to a tax-rate reduction, were great, there would be no objection to the imposition of excessively low MTRs on returns on savings.

Fourthly, as discussed earlier, besides the incentive effect, tax-rate reduction is assumed to have a disincentive effect. As tax-rate reduction could cause these opposing psychological effects, MTRs on returns on savings and investments should not be excessively lowered. If tax-rate reduction were not supposed to have a disincentive effect, there would be no objection to the imposition of excessively low MTRs.

Fifthly, higher-income groups would gain more benefit from tax-rate reduction than lower-income groups for two reasons.

(a) Lower-income earners are concerned with their security. They may then have a tendency to save and invest more in order to benefit from the greater returns to savings and investments due to tax-rate reduction. However, in practice, most of them will be unable to save and invest more because of the limit of their earning opportunity.

(b) Higher-income earners are concerned with "maximum immediate return" and enrichment in addition to their security.[454] They may then have a tendency to save and invest more in order to benefit from the greater returns on savings and investments due to tax-rate reduction. In practice, the rich are able to save and invest more because of their greater capacity to earn.

If the rich gained greater benefit from greater saving and investment than the poor, this would thwart vertical equity/redistribution. For this reason, I completely agree with Kaldor when he writes that "by making the tax sufficiently progressive, it would always be possible to prevent the rich from saving [and investing] too much."[455] Therefore, MTRs on returns on savings and investments should not be excessively lowered.

Sixthly, an excessive rise in saving and investment rates, due to tax-rate reduction, could bring about unpleasant economic consequences. Dalton argues that "if savings much exceed investment, there will be heavy unemployment, widespread business losses, rapidly falling prices and deflation."[456] Conversely, "if investment much exceeds savings, there may indeed be full employment, but also widespread business profits, rapidly rising prices and inflation."[457]

The *Economist* supports the view that unpleasant economic consequences may arise from too much saving, claiming that "...one reason for the country' s economic stagnation is that consumers ... insist on keeping their wallets firmly shut."[458]

For the above reason, MTRs on returns on savings and investments should not be excessively lowered. If tax-rate reduction did not lead to unpleasant economic consequences, there would be no objection to the imposition of excessively low MTRs.

Finally, if MTRs on income from saving and investment were excessively lowered, tax revenue from such income would decline.

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454 Silverman, op.cit.(note43),pp.168, 169

455 Kaldor, op.cit.(note54), p.99

456 Dalton, op.cit.(note30), pp.72-73

457 ibid.p.73

458 Author not identified, "Economics focus A saving grace", The Economist, Vol. 368, No. 8331, July 5th 2003, 83.

3.2.2.7 Changes in the tax-rate schedule and OSMTRS

From the above discussion, an optimal reduction in a MTR is needed. As we have seen, under the current Thai law, interest and dividend income are subject to MTRs ranging from 0% up to 37% (it used to reach 65%). Meanwhile, under UK law for the tax year 2004-05, interest income is subject to MTRs ranging from 10%, 20%, and 40 %; and dividend income is subject to MTRs ranging from 10% up to 32.5 % (it used to reach 98%).

Thus, MTRs on interest and dividend income under both laws have not been excessively lowered. They have now been set within the optimal range and are likely to be in agreement with part of the OSMTRS, which requires a reduction in the disincentive effect. This finding is also related to the third question posed at page 100.

4. Conflict between equity and efficiency, and proposed solutions

4.1 Possible features of the conflict

As discussed in section 2, the progressive rate structure achieves vertical equity/redistribution in two ways.

Firstly, it imposes low tax burdens or low ATRs on low incomes. Low ATRs on the poor are obtained by imposing low MTRs on the earnings of low-income groups.

Secondly, it imposes higher tax burdens or higher ATRs with an increase in income. Higher ATRs with higher incomes are obtained by imposing higher MTRs on larger incomes. By this way, high tax burdens or high ATRs on the rich can be obtained.

The second method leads to inefficiency of taxation. The conflict between equity and efficiency can be categorized below.

(a) Vertical equity/redistribution VS tax avoidance and evasion

Although high MTRs on high-income groups promote vertical equity/redistribution, they provide incentives to avoid and evade tax. Tax avoidance and evasion by high-income groups thwart vertical equity/redistribution and lead to inefficiency of taxation (as discussed in 2.4.3.1 and 3.1.2).

(b) Vertical equity/redistribution VS low administrative and compliance costs

Maintaining higher MTRs on higher incomes helps achieve vertical equity/redistribution. However, this requires there to be a greater number of MTRs and tax bands, causing complexity in the legislation. Additionally, complex legislation is enacted to prevent tax-avoidance schemes resulting from high MTRs. Complex legislation leads to high administrative and compliance costs (as discussed in 3.1.1.1 and 3.1.1.2).

(c) Vertical equity/redistribution VS the disincentive effect

Although very high MTRs achieve vertical equity/redistribution, they have a disincentive effect on economic activities. This is because they are supposed to discourage taxpayers from doing extra work, saving more or investing (as discussed in 3.2.1.4, 3.2.1.6 and 3.2.2.6).

4.2 Proposed solutions to the conflict

The level of MTRs in the tax-rate schedule is the major factor leading to the conflict between equity and efficiency. To reduce the conflict, MTRs must be designed to strike a balance between equity and efficiency. As noted earlier, OSMTRs are supposed to achieve vertical equity/redistribution and least affect efficiency of taxation.

This research proposes the two tax-rate schedule system that is likely to bring about OSMTRs. MTRs and tax bands in the proposed two tax-rate schedules are likely to reduce the conflict between:

(a) vertical equity/redistribution and tax avoidance and evasion,
(b) vertical equity/redistribution and low administrative and compliance costs, and
(c) vertical equity/redistribution and disincentive effects.

4.2.1 Proposal for the two tax-rate schedule system

This research proposes that net/taxable income will be subject to two tax-rate schedules, i.e. one schedule applicable to low-income groups and another to high-income groups.

Each schedule consists of OSMTRs. The schedule for low-income groups contains two tax rates, and the schedule for high-income groups also contains two tax rates with broad rate bands. Net/taxable income which does not exceed a specified amount (e.g. 500,000 baht or £10,000) will be taxed at the two tax rates of 0% and 8% in the schedule for low-income groups. These amounts are assumed to represent the income of low-income and (lower) middle-income taxpayers. In the meantime, net/taxable income which exceeds a specified amount (e.g. 500,000 baht or £10,000) will be taxed at the two tax rates of 8% and 35% in the schedule for high-income groups. These amounts are assumed to represent income of (upper) middle-income, high-income, and highest-income taxpayers. Tax bands in the proposed two tax-rate schedules will be adjusted in line with changes in the retail prices index in each tax year. Examples below will illustrate the proposed two tax-rate schedules.

Example (1): The proposed two tax-rate schedules for Thai law

Chai receives employment income. After subtracting tax reliefs from his assessable income, if his net/taxable income does not exceed 500,000 baht, he will be taxed at the 0% rate on the first 100,000 baht of net/taxable income, and at the 8% MTR on the next 400,000 baht, according to a schedule for low-income groups, as shown below.

A schedule for low-income groups

Band of net/taxable income (baht)	Tax rate (%)
0-100,000	0
100,001- 500,000	8

Noy also receives employment income. After subtracting tax reliefs from her assessable income, if her net/taxable income exceeds 500,000 baht (e.g. 1,000,000 baht), she will be taxed at the 8% MTR on the first 500,000 baht of net/taxable income, and at the 35% MTR on the next 500,000 baht, according to a schedule for high-income groups, as shown below.

A schedule for high-income groups

Bands of net/taxable income (baht)	Tax rates (%)
0-500,000	8
over 500,000	35

Example (2): The proposed two tax-rate schedules for UK law

Tom receives employment income. After subtracting tax reliefs from his assessable income, if his net/taxable income does not exceed £10,000, he will be taxed at the 0% rate on the first £2,000 of net/taxable income, and at the 8% MTR on the next £8,000, according to a schedule for low-income groups, as shown below.

A schedule for low-income groups

Band of net/taxable income (£)	Tax rate (%)
0-2000	0
2001-10,000	8

Nancy also receives employment income. After subtracting tax reliefs from her assessable income, if her net/taxable income exceeds £10,000 (e.g. £50,000), she will be taxed at the 8% MTR on the first £10,000 of net/taxable income, and at the 35% MTR on the next £40,000, according to a schedule for high-income groups below.

A schedule for high-income groups

Bands of net/taxable income (£)	Tax rates (%)
0 -10,000	8
over 10,000	35

The further points to be discussed are to what extent the proposed two tax-rate schedules reduce the conflict between equity and efficiency.

4.2.2 The two tax-rate schedule system and vertical equity/redistribution

The schedule for low-income groups is designed to help reduce tax burdens on low-income and (lower) middle-income earners. Meanwhile, the schedule for high-income groups is designed to impose optimal tax burdens on (upper) middle-income, high-income, and highest-income earners and to discourage tax avoidance and evasion.

4.2.2.1 A schedule for low-income groups

As noted in 2.4.4.2, to achieve greater vertical equity/redistribution at a low-income level, the present number of Thai and UK low- or starting-rate taxpayers should be further lowered. This will further lower the amount and share of income tax paid by low-income groups.[459]

A reduction in the number of low- or starting-rate taxpayers and in the amount and share of tax paid by these groups can be realised by (i) lowering the low or starting rate, (ii) narrowing the low- or starting-rate band, and (iii) raising the level of income subject to the low or starting rate (as discussed in 2.4.4.3).

This research proposes in 4.2.1 that there are two tax rates in the schedule for low-income groups, i.e. the 0% rate applying to the first 100,000 baht or the first £2,000 of net/taxable income, and the 8% MTR applying to the next 400,000 baht or the next £8,000. Additionally, as will be discussed in full detail in Chapter Three, I propose an increase in personal allowances to cover private consumption expenditure per capita (under Thai and UK laws) and to be in line with price inflation (under Thai law).

The proposed zero-rate bracket and the proposed increase in personal allowances will raise the level of income subject to the low or starting rate. As a result, there will be less income and a smaller number of poor people subject to the low or starting rate. This will reduce the present number of Thai and UK low- or starting-rate taxpayers or remove more low-income earners from the PIT system of Thailand and the UK. This will further lower the amount and share of income tax paid by low-income earners and not cause income to be redistributed too much from low-income earners, which will help achieve greater vertical equity/redistribution at a low-income level.

Also, tax burdens on (lower) middle-income earners will be further reduced when the proposed tax-rate schedule for low-income groups is applied. This is for two reasons. Firstly, (lower) middle-income earners will receive tax benefits from a zero-rate bracket. Secondly, the tax rate applicable to (lower) middle-income earners is lowered. As proposed above, the tax rate for (lower) middle-income earners is 8%. This rate will be reduced from 10% under existing Thai law and from 10% and 22% under existing UK law. Additionally, as a result of the proposed increase in personal allowances, tax burdens on (lower) middle-income earners will be further reduced. As discussed in 2.4, a low level of ATRs on low-income groups leads to tax progressivity, which achieves significant vertical equity/redistribution at a low-income level. The following two examples will clarify this point.

Example (i)

Supposing a Thai (lower) middle-income earner has his/her taxable income in 2005 in the amount of 500,000 baht.[460] He/she pays 40,000 baht in tax ((100,000x0%)+(400,000x10%)). His/her ATR is 8% (40,000/500,000). If this person paid tax under the proposed schedule for low-income groups, he/she would pay 32,000 baht in tax ((100,000x0%)+(400,000x8%)). His/her ATR would be 6.4% (32,000/500,000). His/her ATR decreases from 8% to 6.4%. A lower ATR on a Thai (lower) middle-income earner under the proposed schedule for low-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.

Example (ii)

Supposing a British (lower) middle-income earner has his/her taxable income in 2004-05 in the amount of £10,000.[461] He/she pays £1,957.60 in tax ((2,020x10%)+(7980x22%)). His/her ATR is 19.57% (1,957.60/10,000). If this person paid tax under the proposed schedule for low-income groups, he/she would pay £640 in tax ((2,000x0%)+(8,000x8%)). His/her ATR would be 6.4%

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[459] In the past, three proposals are made to reduce tax burdens on low-income groups, as shown in **Appendix XV to Chapter Two**. However, my proposal to use the schedule for low-income groups is different from the previous proposals.

[460] This amount is assumed to represent the income of a (lower) middle-income taxpayer.

(640/10,000). His/her ATR decreases from 19.57% to 6.4%. A lower ATR on a British (lower) middle-income earner under the proposed schedule for low-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.

4.2.2.2 A schedule for high-income groups

As noted in 2.4.4.1, to achieve greater vertical equity/redistribution at a high-income level, an increase in the present number of Thai and UK highest- or higher-rate taxpayers and in the amount and share of income tax paid by high-income groups is required. This proposal can come about via the widening of the present Thai and UK highest- or higher-rate band by lowering the highest- or higher-rate threshold (as discussed in 2.4.4.3).

As noted in 2.3, the highest-rate threshold under the present Thai tax-rate schedule (2005) is 4,000,001 baht. According to the proposed tax-rate schedule for high-income groups, the highest-rate threshold is lowered to 500,001 baht. Meanwhile, as noted in 2.3, the higher-rate threshold under the present UK tax-rate schedule (2004-05) is £31,400. According to the proposed tax-rate schedule for high-income groups, the higher-rate threshold is lowered to £10,001.

Furthermore, according to the proposed schedule for high-income groups, (upper) middle-income, high-income and highest-income earners will not receive tax benefits from a low rate in the proposed schedule for low-income groups, especially the 0% rate. As proposed above, there are only two tax rates under the proposed schedule for high-income groups (i.e.8% and 35%). Under the present Thai tax-rate schedule (2005), high-income groups receive tax benefits from a low rate, i.e. (upper) middle-income earners are taxed at 0%, 10% and 20%, high-income earners at 0%, 10%, 20% and 30%, and highest-income earners at 0%, 10%, 20%, 30% and 37%. Under the present UK tax-rate schedule (2004-05), high-income groups also receive tax benefits from a low rate, i.e. (upper) middle-income earners are taxed at 10% and 22%, high-income earners at 10%, 22% and 40%, and highest-income earners at 10%, 22%, and 40%.

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[461] This amount is assumed to represent the income of a (lower) middle-income taxpayer.

When high-income groups do not receive tax benefits from a low rate including the 0% rate (if the proposed two tax-rate schedules are applied), this will achieve greater vertical equity/redistribution at a high-income level. This is because ATRs on high-income groups will be increased. As discussed in 2.4, a high level of ATRs on high-income groups leads to tax progressivity, which achieve significant vertical equity/redistribution. The following examples will clarify this point.

Example (a)

Supposing a Thai (upper) middle-income earner has his/her taxable income in 2005 in the amount of 1,000,000 baht.[462] He/she pays 140,000 baht in tax ((100,000x0%)+(400,000x10%)+(500,000x20%)). His/her ATR is 14 % (140,000/1,000,000). If this person paid tax under the proposed schedule for high-income groups, he/she would pay 215,000 baht in tax ((500,000x8%)+(500,000x35%)). His/her ATR would be 21.5 % (215,000/1,000,000). His/her ATR increases from 14% to 21.5%. A higher ATR on a Thai (upper) middle-income earner under the proposed schedule for high-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.[463]

Example (b)

Supposing a Thai high-income earner has his/her taxable income in 2005 in the amount of 4,000,000 baht.[464] He/she pays 1,040,000 baht in tax ((100,000x0%)+(400,000x10%)+(500,000x20%)+(3,000,000x30%)). His/her ATR is 26% (1,040,000/4,000,000). If this person paid tax under the proposed schedule for high-income groups, he/she would pay 1,265,000 baht in tax ((500,000x8%)+(3,500,000x35%)). His/her ATR would be 31.63 % (1,265,000/4,000,000). His/her ATR increases from 26% to 31.63%. A higher ATR on a Thai high-income earner under the proposed schedule for high-income groups

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[462] This amount is assumed to represent the income of an (upper) middle-income taxpayer.

[463] To reduce the high tax burden on an (upper) middle-income earner and an (upper) middle-income married couple who have just entered into the proposed schedule for high-income groups, e.g. a person who has his/her taxable income which is slightly over a specified amount (500,000 baht) or a married couple who pay tax under the joint-taxation system in Thailand and whose combined taxable income is slightly over a specified amount (500,000 baht), such as 505,000 baht, the law should allow this person or this married couple to be taxed at the 0% rate on the first 100,000 baht of net/taxable income, at the 8% MTR on the next 400,000 baht, and at the 35%MTR on income over 500,000 baht.

[464] This amount is assumed to represent the income of a high-income taxpayer.

brings about greater tax progressivity, which promotes significant vertical equity/redistribution.

Example (c)

Supposing a Thai highest-income earner has his/her taxable income in 2005 in the amount of 8,000,000 baht.[465] He/she pays 2,520,000 baht in tax ((100,000x0%)+(400,000x10%)+(500,000x20%)+(3,000,000x30%)+(4,000,000x37 %)). His/her ATR is 31.5% (2,520,000/8,000,000). If this person paid tax under the proposed schedule for high-income groups, he/she would pay 2,665,000 baht in tax ((500,000x8%)+(7,500,000x35%)). His/her ATR would be 33.31 % (2,665,000/8,000,000). His/her ATR increases from 31.5% to 33.31%. A higher ATR on a Thai highest-income earner under the proposed schedule for high-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.

Example (d)

Supposing a British (upper) middle-income earner has his/her taxable income in 2004-05 in the amount of £30,000.[466] He/she pays £6,357.60 in tax ((2,020x10%)+(27,980x22%)). His/her ATR is 21.19% (6,357.60/30,000). If this person paid tax under the proposed schedule for high-income groups, he/she would pay £7,800 in tax ((10,000x8%)+(20,000x35%)). His/her ATR would be 26% (7,800/30,000). His/her ATR increases from 21.19% to 26%. A higher ATR on a British (upper) middle-income earner under the proposed schedule for high-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.[467]

Example (e)

Supposing a British high-income earner has his/her taxable income in 2004-05 in the amount of £40,000.[468] He/she pays £10,105.60 in tax ((2,020x10%)+(29,380x22%)+(8,600x40%)). His/her ATR is 25.26%

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[465] This amount is assumed to represent the income of a highest-income taxpayer.

[466] This amount is assumed to represent the income of an (upper) middle-income taxpayer.

[467] To reduce the high tax burden on an (upper) middle-income earner who has just entered into the proposed schedule for high-income groups, e.g. a person who has his/her taxable income which is slightly over a specified amount (£10,000), such as £10,500, the law should allow him/her to be taxed at the 0% rate on the first £2,000 of net/taxable income, at the 8% MTR on the next £8,000, and at the 35%MTR on income over £10,000.

[468] This amount is assumed to represent the income of a high-income taxpayer.

(10,105.60/40,000). If this person paid tax under the proposed schedule for high-income groups, he/she would pay £11,300 in tax ((10,000x8%)+(30,000x35%)). His/her ATR would be 28.25% (11,300/40,000). His/her ATR increases from 25.26% to 28.25%. A higher ATR on a British high-income earner under the proposed schedule for high-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.

Example (f)

Supposing a British highest-income earner has his/her taxable income in 2004-05 in the amount of £50,000.[469] He/she pays £14,105.60 in tax ((2,020x10%)+(29,380x22%)+(18,600x40%)). His/her ATR is 28.21% (14,105.60/50,000). If this person paid tax under the proposed schedule for high-income groups, he/she would pay £14,800 in tax ((10,000x8%)+(40,000x35%)). His/her ATR would be 29.60% (14,800/50,000). His/her ATR increases from 28.21% to 29.60%. A higher ATR on a British highest-income earner under the proposed schedule for high-income groups brings about greater tax progressivity, which promotes significant vertical equity/redistribution.

Additionally, when high-income groups do not receive tax benefits from a zero-rate bracket (if the proposed two tax-rate schedules are applied), this will also help achieve greater vertical equity/redistribution at a high-income level. This is because if there is the extension of a zero-rate bracket in the case where there is one tax-rate schedule, it will be more valuable to high-income groups than to low-income groups. (More discussion follows in Chapter Three.)

As to be discussed in full detail in Chapter Three, to prevent the rich from receiving greater tax benefit from an increase in personal allowances, I propose to phase out or cancel personal allowances for the rich, particularly for high- and highest-income earners. This will also promote vertical equity/redistribution.

Moreover, lowering the top rate in the proposed schedule for high-income groups (from 37% to 35% under Thai law, and from 40% to 35% under UK law) is unlikely to reduce the amount and share of income tax paid by high-income groups in Thailand and the UK for three reasons.

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[469] This amount is assumed to represent the income of a highest-income taxpayer.

Firstly, even though the top rate is lowered, there are high ATRs on high-income groups because these groups do not receive tax benefits from a low rate (as discussed in examples (a) – (f) above).

Secondly, lowering the top rate and having only two tax rates in the proposed schedule for high-income groups are likely to reduce incentives for the top-rate taxpayers in both countries to avoid or evade tax. (More discussion on this point follows in 4.2.3.1).

Thirdly, it is likely to be a very large number of Thai and British people paying tax at the top rate because of the very width of the highest-rate band in the proposed schedule for high-income groups.

4.2.3 The two tax-rate schedule system as a solution to the conflict

As we have seen in 4.2.2, the proposed system of two tax-rate schedules is likely to generate OSMTRs, resulting in significant vertical equity/redistribution. The existence of MTRs and tax bands in the proposed two tax-rate schedules is also believed to mean that there will be OSMTRs which will least affect efficiency of taxation and help reduce the conflict between equity and efficiency. The analysis and discussion in 4.2.3.1, 4.2.3.2 and 4.2.3.3 will support this supposition.

4.2.3.1 The two tax-rate schedule system as a solution to conflict between vertical equity/redistribution and tax avoidance and evasion

High MTRs on high incomes are supposed to achieve a desired redistribution (as discussed in 2.2). However, if MTRs are made much higher on higher incomes, there may be more tax avoidance and evasion (as discussed in 2.4.3.4).

As discussed in 2.4.3.4 and 2.4.3.5, changes in the tax-rate schedule via the four methods (i.e. (a) lowering MTRs, (b) reducing the number of tax bands and MTRs, together with widening tax bands, (c) setting the top MTR to be no different from the top rate of corporation tax, and (d) not to exceed 50%) are likely to discourage tax avoidance and evasion, which will promote vertical equity/redistribution at lower MTRs.

As also discussed in 3.1.2, having lower MTRs, fewer tax bands and MTRs, and wider tax bands at all income levels (except for expanding the low- or starting-rate band) is likely to promote efficiency of taxation. This is because they make tax avoidance and evasion less desirable, thus helping to reduce revenue loss and administrative and compliance costs (as discussed in 3.1.2.1, 3.1.2.2 and 3.1.2.3).

As we have seen, there are low MTRs (the top rate below 50%), very few tax bands and MTRs, and wide tax bands in the proposed two tax-rate schedules. Thus, the existence of MTRs and tax bands in the proposed two tax-rate schedules is likely to reduce incentives for taxpayers to avoid or evade tax, which promote both vertical equity/redistribution and efficiency of taxation simultaneously.

4.2.3.2 The two tax-rate schedule system as a solution to conflict between vertical equity/redistribution and low administrative and compliance costs

Multiple MTRs and tax bands, which are required to maintain higher MTRs with higher incomes to help achieve vertical equity/redistribution, cause the inherent complexity within the tax-rate schedule and complexity in tax legislation and in the taxing process (as discussed in 3.1.1.1 and 3.1.1.2). This leads to high administrative and compliance costs. Simplicity in the tax-rate schedule, in tax legislation and in the taxing process is therefore required to reduce such costs (as discussed in 3.1.1.3).

As we have seen, having very few MTRs and tax bands in the proposed two tax-rate schedules can help achieve vertical equity/redistribution. They are also likely to generate simplicity in the tax-rate schedule.

Moreover, simpler legislation is likely to occur since complex legislation to prevent tax-avoidance schemes may not be necessary if the proposed two tax-rate schedule system were put into practice to discourage tax avoidance and evasion.

Simplicity in the taxing process will also occur when low-income earners are moved out of the PIT system. This will result from increasing the amount of personal tax allowances along with using a zero-rate bracket in the proposed schedule for low-income groups. The removal of low-income earners from the PIT system promotes vertical equity/redistribution and generates low administrative and compliance costs at the same time.

Finally, the two tax-rate schedule system can be used to solve rate differentials. A reduction in rate differentials between earned and unearned income will strike the balance between equity and efficiency.

Rate differentials between earned and unearned income cause inequity in taxation. As noted in 2.3, all types of income (earned and unearned income) are charged with tax at the same rate in the present Thai tax-rate schedule (0%, 10%, 20%, 30% and 37%). However, under Thai law, a taxpayer who derives interest or dividend income may be taxed only at 15% or 10% respectively; provided that his/her interest or dividend income is already taxed at source at the rate of 15% or 10%, and he/she elects to pay tax on interest or dividend income through withholding at source and not to include such income as assessable income in the end-of-year tax return.

Comparing two Thai people with equal income but from different sources, one whose income is taxed at 0%, 10%, 20%, 30% and 37% (e.g. a salary earner) has disposable income during the tax year less than another whose income is interest income which is taxed at 15%. Therefore, horizontal inequity emerges, and there is violation of vertical equity/redistribution since income is redistributed from the former to the latter. Horizontal inequity and violation of vertical equity/redistribution also occur under UK law but are less severe than those under Thai law. This is because there are slight rate differentials between earned income, non-dividend savings income, and dividend income under UK law, as noted in 2.3.

Rate differentials also cause complexity in tax legislation (as discussed in 3.1.1.1). Reducing rate differentials will bring about simpler legislation and lower administrative and compliance costs (as discussed in 3.1.1.3).

There are still rate differentials between earned and unearned income under the present Thai and UK tax-rate schedules. Therefore, this research proposes that earned and unearned income in both countries should be taxed at the same rates, i.e. those under the proposed two tax-rate schedules. Thus, this proposal is likely to bring about horizontal equity, avoid violation of vertical equity/redistribution, and lead to simpler legislation.

4.2.3.3 The two tax-rate schedule system as a solution to conflict between vertical equity/redistribution and disincentive effects

Despite helping achieve vertical equity/redistribution, high MTRs are thought to have a disincentive effect (as discussed in 3.2.1.1). Lower MTRs are therefore required to reduce the disincentive effect. However, a high ATR is believed to magnify the incentive effect. Increasing MTRs as a means to increase the ATR is also believed indirectly to support incentives to work, save and invest (as discussed in 3.2.1.2).

According to the theoretical analysis above, the progressive rate structure creates "the countervailing effects" of incentive and disincentive effects on work effort. As discussed in 3.2.1.4, empirical studies support the countervailing effects, but both disincentive and incentive effects on work effort are small in practice. In addition, tax-rate reduction has little impact on work incentives according to empirical studies, which is the opposite of the findings of theoretical analysis (as discussed in 3.2.1.5).

This research established in 3.2.1.4 and 3.2.1.6 that very high MTRs of around 90% or more probably create disincentives to work when high-income taxpayers have no chance to avoid and evade tax. However, if the top rates were not very high, i.e. around 50-65% (as used to be the case in Thailand and the UK), these rates would have no significant effect on work decisions according to empirical evidence and the analysis in this research. Therefore, tax reform to reduce MTRs to reduce the disincentive effect on work effort seems unnecessary.

As also established in 3.2.1.6, the current top rates of Thailand and the UK have been set optimally not only to discourage tax avoidance and evasion but also to prevent probable disincentives to work. However, the greatest benefit of tax-rate reductions from 50-65% to 37% (under Thai law) and to 40% (under UK law) is likely to be the discouragement of tax avoidance and evasion rather than the prevention of probable disincentive effects or hope for incentive effects. It would be unacceptable if the current top rates of both countries were further cut down on labour supply grounds.

The top rate in the proposed schedule for high-income groups is set slightly lower than the current top rates of Thailand and the UK. This is for the purpose of reducing incentives to avoid and evade tax rather than to prevent the disincentive effect on work effort. As we have seen, MTRs in the proposed two tax-rate schedules are not very high. Therefore, these rates would not certainly create disincentives to work.

According to theoretical analysis, the progressive rate structure also creates opposing psychological effects, i.e. negative/disincentive and positive/incentive effects on saving and investment (as discussed in 3.2.2.1 and 3.2.2.2). However, this research established in 3.2.2.6 that the progressive rate structure is more likely to create negative than positive effects on saving and investment rates. Despite this establishment, an optimal reduction in MTRs for the purpose of boosting saving and investment rates is required. In other words, MTRs on returns on savings and investments should not be excessively lowered, particularly on interest and dividend incomes for high-income earners.

As compared to those in the past, MTRs on interest and dividend income under both Thai and UK laws have been considerably reduced. However, the MTRs of both countries have not been excessively lowered. MTRs on interest and dividend income under the current Thai and UK laws are likely to be set within the optimal range (as discussed in 3.2.2.7). Additionally, the highest MTRs on interest and dividend income under both laws are now below 50%, and so are unlikely to create disincentives to save and invest as is believed MTRs of 50% or more are likely to do.[470]

This research proposes in 4.2.3.2 that unearned income in both countries should be taxed at the same rates as earned income, i.e. those under the proposed two tax-rate schedules. MTRs in the proposed two tax-rate schedules are not very high, and the highest MTR in the schedule for high-income groups is below 50%. Therefore, these rates are unlikely to create disincentives to save and invest.

5. Conclusion

In theory, the progressive rate structure requires the ATR to rise with higher incomes to achieve vertical equity/redistribution. The multiple rate system is the more effective method to approach to the progressive rate structure and to achieve significant vertical equity/redistribution.

The multiple rate system requires can be designed to impose low MTRs on the poor, to impose high MTRs on the rich, and to increase MTRs on higher

[470] In my view, an MTR below 50% is unlikely to have a disincentive effect for psychological reasons.

incomes. Although high MTRs generate high ATRs on the rich and promote vertical equity/redistribution, they impede efficiency of taxation.

The tax-rate schedules under Thai and UK laws adopt a multiple rate system. Currently, neither schedule is progressive enough to achieve significant vertical equity/redistribution because there are lower and fewer MTRs on high incomes, wider and fewer tax bands, and a top MTR of below 50%. Therefore, the current features of both schedules achieve vertical equity/redistribution to some extent. However, both schedules promote efficiency because they bring about simplicity in the legislation and reduction in incentives to avoid and evade tax and in disincentive effects.

This research has found that OSMTRs should be established to achieve vertical equity/redistribution to a greater extent and still promote efficiency. The proposed two tax-rate schedule system, i.e. one schedule for low-income groups and another for high-income groups, are believed to achieve these purposes. This is because MTRs in the two tax-rate schedules are supposed to generate OSMTRs to provide benefits for poor and rich people simultaneously.

Chapter Three

An Optimal Income-Tax Base

1. Introduction

This chapter examines (a) the structures of the income-tax base under Thai and UK laws, (b) their effects on equity and efficiency, (c) the conflict between equity and efficiency caused by the tax base.

In analyzing the effect on equity, the broad tax base and the erosion of the tax base by tax reliefs will be taken into account. Proposals will also be made to promote equity as this research discovers that tax reliefs adversely affect equity.

In analyzing the effect on efficiency, this research will discover to what extent the erosion of the tax base by tax reliefs affects tax revenue, administrative and compliance costs, and deadweight loss. Proposals will also be made to promote efficiency as this research discovers that such erosion leads to inefficiency of taxation.

Finally, as tax reliefs are found to cause the conflict between equity and efficiency or lead to both inequity and inefficiency of taxation, proposals will be made to improve equity and efficiency simultaneously.

2. Concepts and effects of an income-tax base on equity

2.1 Income subject to tax

Sandford points out that "further reduction in inequality of income by taxation should be sought by widening the income tax base."[471] One method for widening the income-tax base is to define broadly the terms of income.

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[471] Sandford, op.cit.(note19), p.156

2.1.1 Definition of income in principle

The PIT is a tax imposed on an individual's income. Income thus serves as the base for his/her liability to the PIT. Additionally, the PIT is required to apply the ability-to-pay principle to achieve equity, and income can serve as a measure of this ability.

If income were defined as net accretion to an individual's economic power, i.e. to his/her net worth and spending power during a given period, income would serve as an appropriate measure of the ability to pay.[472] PIT law should therefore give a definition of income.

According to the 'Haig-Simons' concept, whatever is recognized as net accretion to a person's economic power during a given period should be income subject to tax.[473] This is widely recognized by scholars as "a comprehensive income-tax base"[474], or "a comprehensive income tax"[475] ("the CIT").

Under the CIT, income subject to tax would include all types of item which amount to economic accretion, namely earned income (e.g. wages, salaries)[476], unearned income (e.g. rent, interest, dividends)[477], non-money income[478] including income in kind[479] or imputed income (e.g. imputed rent from owner-occupied housing)[480] and benefits in kind (e.g. fringe benefits)[481]; capital gains[482], windfall gains[483], winnings from bets[484], gifts[485], inheritances[486], government transfer payments (e.g. social security benefits)[487], etc.

Accordingly, if the law defines the terms of income under the CIT idea, this would help widen the income-tax base. This would serve not only as an appropriate

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[472] James and Nobes, op.cit.(note5), p.166.
[473] Sandford, op.cit.(note195), p.42
[474] Shipwright and Keeling, op.cit.(note182), p.4
[475] Sandford, op.cit. (note195), p.42
[476] Kraiyudht Dhiratayakinant, Income Tax Theory and the Income Tax of Thailand (Bangkok: Duangkamol Publisher, 1978), 3.
[477] ibid.p.3
[478] Rangsan Thanapornpan, Taxation Theory (Bangkok: Kled Thai Publisher, 1973), 212.
[479] Dhiratayakinant, op.cit.(note476), p.3
[480] R.A. Musgrave and P.B. Musgrave, Public Finance in Theory and Practice, 3rd ed. (London: McGraw-Hill, 1980), 244.
[481] Sandford, op.cit.(note19), p.127
[482] Thanapornpan, op.cit.(note478), p.212
[483] James and Nobes, op.cit.(note5), p.166
[484] ibid.p.166
[485] ibid.p.166
[486] ibid.p.166
[487] Eckstein, op.cit.(note49), p.60

measure of ability to pay[488] but also as an appropriate base for income tax.[489] This could achieve equity because "it treats individuals with different sources of income uniformly"[490]; similarly, "income from all sources would be treated equally."[491] The discussion below will elucidate this argument.

Income is accepted as net accretion to economic power; therefore, people with higher income have greater ability to pay tax than those with lower income. If the former paid less tax than the latter (because the former' s income is not included in the definition of income but the latter's is included), there would be violation of vertical equity/redistribution. The broad definition of income could help prevent this violation. This is because under the broad definition of income, all forms of income of people with higher income will be included in the definition of income the same as the income of people with lower income. This finding may dismiss the argument that the CIT is "strong on horizontal equity", but "it could, of itself, provide no structure for vertical equity."[492] Example 3.1 in **Appendix I to Chapter Three** helps clarify this point.

Additionally, horizontal equity and the redistribution concept will not be violated. This is because under the broad definition of income, all forms of income will fall within the same tax base. Consequently, a person who receives jewels, as gifts, which are worth about £200,000, will pay the same tax as another who receives a salary of £200,000. There is no income redistribution between the same income class. Example 3.2 in **Appendix I to Chapter Three** helps clarify this point.

2.1.2 Income subject to tax in practice

The CIT would in principle achieve equity**.** However, the CIT has not been fully adopted because of three practical problems, i.e.

(a) the difference between capital and income,

(b) practical difficulties of ascertaining and measuring certain forms of income, and

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488 The Musgraves, op.cit.(note480), p.255

489 Alan J. Auerbach, "Taxation of Income", The New Palgrave: A Dictionary of Economics, John Eatwell, Murray Milgate and Peter Newman, eds. (London: The Macmillan Press Limited, 1987), 605.

490 ibid.p.605

491 Nightingale, op.cit.(note65), p.51

492 Tiley, op.cit.(note141), p.13

(c) political consideration.

As regards (a), capital gains are taxed separately from income in various countries[493]because capital and income are different. As Glover notes, "the trees represent the capital and the fruit the income."[494] Additionally, "the courts [in the UK] have adopted a view that capital gain should and can be distinguished from income."[495] Capital gains are exempt from income taxation in the UK,[496] and they have been charged to capital gains tax since 1965.[497] However, capital gains are subject to the PIT in Thailand.[498]

As regards (b), it is argued that "the precise meaning of income and its measurement are amongst the most difficult and controversial areas in accountancy."[499] It is difficult to measure and tax the equivalence of certain types of item to income, i.e. "non-market sources of income."[500] The imputed rent on owner-occupied housing is an example of non-market sources of income.[501] There are six EU states imposing tax on the imputed rent at present.[502] This "had been in force in the UK as the original Schedule A"[503], and was abolished in 1963.[504] One of the reasons why this tax was abolished concerns the measurement of income, e.g. "there was constant pressure for deductions for repairs in computing taxable income."[505] This tax has never come into force in Thailand.

It is also argued that income in kind, such as fringe benefits "is often not taxed adequately, or even not taxed at all, mainly because it is simply too difficult to measure or administer."[506] For example, the value of company cars for personal use and free health insurance could be worked out as a cash value "but this is a difficult

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[493] Throop Smith,op.cit.(note401), p.916
[494] G.N. Glover, "Revenue Law", Introduction to English Law, 12th ed., Philip S. James, ed. (London: Butterworths, 1989), 254.
[495] Tiley, op.cit.(note141), p.25
[496] Bannock et al., op.cit.(note249), p.198
[497] Tiley, op.cit.(note141), p.25
[498] Paichit Rojanavanich et al., A Textbook on the Revenue Code (Bangkok: Samchareon-pranich (Bangkok) Co., Ltd., 2001), 1-001.
[499] Shipwright and Keeling, op.cit.(note182), p.4
[500] Auerbach, op.cit.(note489), p.605
[501] ibid.p.605
[502] Author not identified, "Taxing houses: Hands off", The Economist, Vol. 369, No. 8347, October 25th, 2003, 34.
[503] Tiley, op.cit.(note141), p.20
[504] The Economist, op.cit.(note502), p.34
[505] Tiley, op.cit.(note141), p.21
[506] James and Nobes, op.cit.(note5), p.31

and controversial process."[507] Some of fringe benefits are charged to income tax in the UK and Thailand, but they are subject to special rules on computing taxable income.

As regards (c), the CIT has not been fully put into practice due to "administration and politics."[508] Imputed rent is exempt from income taxation in some countries not only because of "difficulties in measuring the value of the imputed rent", but also because of "the political unpopularity that would be associated with any attempt to tax this nonmonetary form of income."[509] Furthermore, legacies and most gifts are taxed separately from income in the UK, being charged to inheritance tax and capital gains tax.[510] Meanwhile, in Thailand, legacies and gifts fall within the income-tax base.

The main charging sections under Thai law are Sections 39 and 40 of the RCT. Under Section 39, "assessable income" means (a) all money income, including (b) properties, (c) any other benefits received which are ascertainable in terms of money, (d) any amount of tax and duty paid for the taxpayer by the payer of income or by any other person in respect of any category of income under Section 40, and (e) the tax credit under Section 47 bis.[511] Under Section 40, there are 8 categories of assessable income, which will be dealt with below.

Under Section 39 of the RCT, the income-tax base is defined to cover all money income and all types of item which are an accretion to individuals' economic power and equivalent to money income. Section 40 of the RCT specifies 8 categories of assessable income within the broad scope of income subject to tax. (The full text of Section 40 can be found in **Appendix II to Chapter Three**).

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507 Andrew Leicester, "Thinking about inequality", Economic Review, Volume 21, Number 2, November 2003, 32-33.
508 Auerbach, op.cit.(note489), p.605
509 Janet Stotsky, "The Base of the Personal Income Tax", Tax Policy Handbook, Parthasarathi Shome, ed. (Washington, D.C.: IMF, 1995), 122.
510 Bannock, op.cit.(note249), p.208
511 The tax credit which is included in assessable income subject to PIT is the tax credit for dividends received from juristic companies and partnerships set up under Thai law. The amount of tax credit is arrived at by taking into account the corporate income-tax rate to be paid by a company or partnership who is the payer of dividend divided by the difference between 100 minus such income-tax rate. The resultant quotient will then be multiplied by the amount of dividend received. The result will be the amount of tax credit. (Section 47 bis, RCT) (V.T.Associates, The Revenue Code as amended up to May 1993 (Bangkok: ACREV, 1993), 33.)

Category (1) applies to earned income, covering all money, property and fringe benefits from employment.

Category (2) applies to earned income, covering all money, property and benefits in kind from a post, office of employment or self-employment.

Category (3) applies to unearned income, covering income from intangible properties and from annuities.

Categories (4) applies to (a) unearned income, covering interest, dividends and other income from investments, (b) capital gains from the amalgamation, acquisition or dissolution of juristic companies or partnerships[512], and (c) capital gains from the sales of partnership holdings, shares, debentures, bonds, or bills or debt instruments.[513]

Category (5) applies to unearned income from rent of tangible properties and from breach of contract.

Category (6) applies to earned income, covering the income of self-employed persons from the liberal professions.

Category (7) applies to earned income, covering the income of self-employed persons, such as contractors.

Category (8) applies to earned income, unearned income, windfall gains, winnings from bets, gifts, inheritances, and the like because this category applies to income from business, commerce or any other activities not specified in (1) through (7). Capital gains are also taxed under this category. As Richupan notes, "it is clear that 'income from any other activities not specified in (1) to (7)' included capital gains other than those of (4)."[514] Capital gains which are charged under Category (8) include gains from sales of immovable property. Windfall gains, winnings from bets, gifts, inheritances and miscellaneous income (e.g. the discharge from a debt and loans) are charged under Category (8), as explained above.[515] Additionally,

(a) there is no inheritance tax taking effect;

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[512] Somchai Richupan, Analysis of the Personal Income Tax in Thailand (A Report to Fiscal Policy for Resource Mobilization Study sponsored by the World Bank), November 1980, 19-20; and Chaisith Trachudham, Revenue Law: Volume one, 2[nd]ed. (Bangkok: T.Training Center, a year of publication not identified), 89.

[513] Richupan, op.cit.(note512), p.20; and Trachudham, op.cit.(note512), p.90

[514] Richupan, op.cit.(note512), p.20

[515] In practice, it is difficult to impose tax on income from bets. The taxation of income from bets requires efficient tax administration.

(b) the practice of the Revenue Department of Thailand (the "RD") asserts, "any income not exempt from tax nor defined under paragraphs (1) through (7) shall be income under this paragraph (8)"[516];

(c) if there was no evidence proving that the income in question falls under Categories (1) through (7), such income would be treated as income under Category (8)[517]; and

(d) Royal Decree No. 11 exemplifies a number of types of income which are treated as income under Category (8), for example, income from "the business of selling any articles which are not manufactured by the seller."[518]

Altogether, it seems that Thai law has adopted the CIT idea to a great extent. However, it cannot be concluded that the Thai income-tax base effectively operates to promote equity because "the list of exemptions is rather extensive."[519]

Meanwhile, the TA 1988 does not define the terms of income subject to tax. Income used to be charged to income tax according to the sources of income as listed in the Schedules of the TA 1988. At present, for the proposes of section 1(1) of the TA 1988 (the general charge to income tax), income is charged to income tax under the provisions of the Income Tax (Earnings and Pensions) Act 2003 (the "ITEPA 2003") and of the Income Tax (Trading and Other Income) Act 2005 (the "ITTOIA 2005"). In other words, charges to income tax under the Schedules of the TA 1988 are now replaced by those charges under the ITEPA 2003 (which has operated from 6 April 2003) and the ITTOIA 2005 (which has operated from 6April 2005).

Under the ITEPA 2003, income tax is charged on employment income, pension income and social security income.[520] Most of the Schedule E provisions of the TA 1988 were transferred to the ITEPA 2003 without fundamental changes under the Tax Law Rewrite project.

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[516] Suvarn Valaisathien, New Thai Taxation (Bangkok: Nititham, 1993), 9.
[517] The Supreme Court's decision No.3201/1973
[518] Subsection (25), Section 8, Royal Decree No.11 (1959)
[519] Richupan, op.cit. (note512), pp. 15-16
[520] Section 1(1), ITEPA 2003

Under the ITEPA 2003, employment income means earnings[521], any amount treated as earnings (such as payments where employee absent because of sickness or disability)[522], or any amount which counts as employment income[523](i.e share-related income).[524] Pension income means the pensions, annuities and income of other types listed in the section (such as United Kingdom pensions, foreign pensions).[525] Social security income that is taxable income means the United Kingdom social security benefits listed in Table A (including bereavement allowance, carer's allowance, incapacity benefit, income support, jobseeker's allowance, statutory adoption pay, statutory maternity pay, statutory paternity pay and statutory sick pay), any foreign benefit if (a) it is substantially similar in character to a benefit listed in Table A, and (b) it is payable to a person resident in the United Kingdom.[526]

Under the ITTOIA 2005, income tax is charged on trading income, property income, savings and investment income, and certain miscellaneous income.[527] Most of the Schedules A, D, and F provisions of the TA 1988 were transferred to the ITTOIA 2005 without fundamental changes under the Tax Law Rewrite project.

Under the ITTOIA 2005, trading income includes the profits of a trade, profession or vocation, amounts treated as adjustment income, and post-cessation receipts arising from a trade.[528]

Property income includes the profits of a UK property business or an overseas property business, amounts treated as adjustment income, rent receivable in connection with UK mines, quarries and other concerns, rent receivable for UK electric-line wayleaves, post-cessation receipts arising from a UK property business, and overseas property income of a person to whom the remittance basis applies.[529]

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[521] Earnings means "(a) any salary, wages or fee, (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or (c) anything else that constitutes an emolument of the employment." (Section 62 (2), ITEPA 2003)

Money's worth means "something that is (a) of direct monetary value to the employee, or (b) capable of being converted into money or something of direct monetary value to the employee". (Section 62 (3), ITEPA 2003)

[522] Section 7 (5), Section 221, ITEPA 2003

[523] Section 7 (2), ITEPA 2003

[524] Section 7 (6), ITEPA 2003

[525] Section 566 (2) and (4), ITEPA 2003

[526] Sections 657 (2) (a) (c), 660 (1), and 678 (1), ITEPA 2003

[527] Section 1(1), ITTOIA 2005

[528] Section 3 (1), ITTOIA 2005

[529] Section 260 (1), ITTOIA 2005

Savings and investment income include interest, dividends and other distributions from UK resident companies, dividends from non-UK resident companies, stock dividends from UK resident companies, release of loan to participator in close company, purchased life annuity payments, profits from deeply discounted securities, gains from contracts for life insurance etc., distributions from unauthorised unit trusts, profits and gains from the disposal of deposit rights, disposals of futures and options involving guaranteed returns, and sales of foreign dividend coupons.[530]

Miscellaneous income includes receipts from intellectual property, income from non-trade businesses involving the exploitation of films or sound recordings, income derived from a relevant telecommunication right that is not used or held for the purposes of a trade, profession or vacation, amounts treated as income of a settlor, beneficiaries' income from estates in administration, annual payments not otherwise charged, and income not otherwise charged.[531]

Unlike the RCT, the TA 1988, the ITEPA 2003 and the ITTOIA 2005 have not given a definition of income to cover all types of item equivalent to income. Any incomes that fall outside the provisions of the ITEPA 2003 and the ITTOIA 2005 are not included in the income-tax base and charged to income tax. Thus, some receipts are not subject to income tax, e.g. imputed rent, capital gains etc.

Although there is no definition of income in the Acts[532], Section 687 (1) of the ITTOIA 2005 provides that income tax is charged on "income from any source that is not charged to income tax under or as a result of any other provision of [the ITTOIA 2005] or any other Act."[533] This provision replaces Schedule D Case VI of the TA 1988 which applies to "any annual profits or gains not falling under any other Case of Schedule D and not charged by [any other] Schedule." Morse and Williams note that Schedule D Case VI is necessary because "income is not defined in the

[530] Section 365 (1), ITTOIA 2005
[531] Section 574 (1), ITTOIA 2005
[532] There is expansion of a word "income" in the ITTOIA 2005 without defining it. According to Section 878 (1) of the ITTOIA 2005, "income" includes (but does not mean) "amounts treated as income (whether expressly or by implication)."
[533] Section 687 (1), ITTOIA 2005

Acts, and it is clear that the tax on income is not a universal tax on all possible forms of income."[534]

Section 687 (1) of the ITTOIA 2005 is likely to widen the income-tax base more than Schedule D Case VI did. This is for two reasons

Firstly, Section 687 (1) employs the phrases which are likely to catch more income subject to tax than the phrases employed by Case VI. Under Section 687 (1), what is taxable is "income from any source that is not....." This phrase is likely to have wider meaning and to catch more income subject to tax than the phrase "any annual profits or gains not falling..." which is employed by Case VI. Morse and Williams note that "profits" and "gains" mean the same thing[535], and "annual" mean that "the profits must be income profits and not capital profits.[536]

Additionally, income which will be charged to income tax under Section 687 (1) must be income "that is not charged to income tax under or as a result of any other provision of [the ITTOIA 2005] or any other Act." This phrase is likely to have wider meaning and to catch more income subject to tax than the phrase "[profits or gains] not falling under any other Case of Schedule D and not charged by [any other] Schedule" which is employed by Case VI.

Secondly, Case VI has a limited use in practice because of the interpretation of the phrase "annual profits." As Tiley notes,

> "The courts have construed that phrase in a limited way – generally, profits are income only if they possess a quality of recurrence – and have confined Case VI to profits similar to those caught by the other Schedule and Cases."[537]

However, Morse and Williams argue that "annual" does not mean that "the profits must be recurring."[538] This interpretation of Case VI by the courts does not help considerably to widen the income-tax base.

Altogether, Schedule D Case VI affects the comprehensive income-tax base. However, Section 687 (1) of the ITTOIA supports the CIT. In addition, the

[534] Morse and Williams, op.cit.(note15), 118
[535] ibid.p.119
[536] ibid.p.119
[537] Tiley, op.cit.(note141), p.131
[538] Morse and Williams, op.cit.(note15), p.119

adaptability of the tax system and the practice in the UK help support the CIT. This will be clarified below.

Although capital gains, legacies, and most gifts are not charged to income tax, they are charged to other taxes, i.e. capital gains tax or inheritance tax. Moreover, capital gains have been taxed at the same income tax rates since 1988.[539] It is then argued that "some elements of the [CIT] idea have been adopted [into the UK tax system]."[540] This adaptation solves the problem of the deficiency of the income-tax base and widens the base of the UK tax system.

Employment income (the former Schedule E income) which is now charged under the ITEPA 2003 extensively covers any receipt by an employee in the course of employment. Employment income under the ITEPA 2003 includes money income and fringe benefits. To cope with the practical difficulties of ascertaining and measuring fringe benefits, there are special rules governing their valuation. As Melville notes,

> "For the purpose of assessing benefits, employees are divided into two classes, "P11D employees" and "lower-paid employees"…..As a general rule, lower-paid employees are taxed only on benefits that are convertible into money, and then only on the amount of money that the employees could obtain in this way. ….. P11D employees are generally taxed on the cost to the employer of providing the benefits, whether or not these benefits are convertible into money."[541]

Melville also notes that some fringe benefits are assessable in the same way on both classes of employees.[542] Such benefits include "vouchers which may be exchanged for goods or services" and "living accommodation."[543] For the former, employees are assessed on "the cost to their employer of providing vouchers which may be exchanged for goods or services."[544] For the latter, an employee is taxed on "the annual value of the accommodation" where an employer is the owner of such

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[539] Nightingale, op.cit.(note65), p.51

[540] ibid.p.51

However, capital gains are subject to many more exemptions and reliefs as compared to income.

[541] Alan Melville, Taxation: Finance Act 2003, 9th ed. (Essex: Pearson Education Limited, 2004), 91.

[542] ibid.p.92

[543] ibid.p.92

[544] ibid.p.92

accommodation.[545] In this case, an employee is taxed on "the greater part of the rent paid by the employer and the accommodation's annual value."[546] There are also special rules assessing for P11D employees certain fringe benefits such as cars, provided for private use.[547]

In all, it seems that UK law has adopted the CIT idea to a great extent. Nevertheless, there are still other matters that may adversely affect the widening of the UK tax base.

(a) Although capital gains are chargeable to capital gains tax, this tax has operated unsatisfactorily.[548] In 2000-2001, the capital gains tax amounted to 2.17% of the total sum raised by direct taxes.[549]

(b) Certain types of income are excluded from the tax base.[550]

2.2 Tax-free income

The tax base is in practice eroded by tax-free income. There are three assumptions relating to this erosion, namely

(a) if an erosion meant a reduction in the tax burden on people with less ability-to-pay, this erosion would promote vertical equity/redistribution;
(b) if it meant a reduction in the tax burden on people with greater ability-to-pay, this erosion would thwart vertical equity/redistribution; and
(c) if it did not take a different amount of income in tax from people with the same ability-to-pay, this erosion would promote horizontal equity and not violate the redistribution concept.

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[545] ibid.p.93
[546] ibid.p.93
[547] ibid.p.94
[548] Tiley, op.cit.(note141), p.25
[549] Chris Whitehouse et al., Revenue Law-Principles and Practice, 21st ed. (London: Reed Elsevier (UK) Ltd., 2003), 6.
[550] ibid.p.17

2.2.1 Concepts of tax-free income

Tax-free income can also be described as "tax reliefs." They are put into PIT law mainly to promote (a) satisfying the equity of income redistribution, and (b) benefiting particular types of individual or activity.

The OECD defines tax reliefs as "a generic term to cover all the means of reducing income tax liability."[551] Similarly, tax reliefs are termed by *A Dictionary of Taxation* as "a concession in respect of tax which would otherwise be payable."[552] Given this, "any credit, exemption or deduction allowed in calculating a liability to tax"[553] can be regarded as tax reliefs.

The Revenue notes that tax reliefs are termed "structural reliefs" if they are used:

(a) to allow for "the costs incurred in generating incomes",

(b) to reflect "the broad objectives of the tax", and

(c) to simplify "compliance or administration."[554]

Income redistribution is one objective of the PIT system. Therefore, if tax reliefs were designed to reflect "the broad objectives of the tax", they are likely to promote the equity of income redistribution. Similarly, structural reliefs could satisfy the ability-to-pay principle and the concept of progressivity to achieve vertical and horizontal equity. However, most writers argue that structural reliefs (e.g. tax allowances) are designed to achieve horizontal equity. For example, the OECD states:

> "Both tax allowances and tax credits may be seen as means for achieving horizontal equity."[555]
>
> "One view is that vertical equity is best obtained through the operation of the progressive rate schedule. On this view, differences in taxable capacity should be reflected in the taxable income to which the tax schedule is applied. Any group of taxpayers whose taxable capacity is affected in the same way

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[551] OECD, op.cit.(note70), p.13

[552] James, op.cit.(note2), p.152

[553] European Commission, Tacis: Dictionary of taxation terms (Brussels: European Commission, 1996), Clause 351

[554] Inland Revenue, Tax Expenditures and Ready Reckoner: Main tax expenditures and structural reliefs (http://www.inlandrevenue.gov.uk/stats/tax_expendit.../g_t05_1.ht, as of 11/09/03), 5.

[555] OECD, op.cit.(note70), p.51

by family responsibilities or expenditure for which relief is given should all have their taxable incomes reduced by the same amount. Each such group is then subject to the same degree of progressivity relative to taxable capacity as income increases. This view leads to the adoption of tax allowances."[556]

I do not completely agree with both statements. As discussed in 2.1, income is the appropriate measure of taxable capacity. Nevertheless, other factors (i.e. personal circumstances) can determine differences in taxable capacity. Structural reliefs aim to reduce taxable income and tax liability. Therefore, if they reduced the taxable incomes and tax liabilities of people with less taxable capacity more than those of people with greater taxable capacity, they could achieve vertical equity.

Accordingly, vertical equity can be obtained through structural reliefs in addition to the progressive rate structure, that is by dissimilar tax treatment for people with different taxable capacity. These differences can be reflected in two stages.

Firstly, they can be reflected in personal circumstances to which structural reliefs are applied.

Secondly, they can be reflected in the taxable income to which the progressive rate structure is applied.

This standpoint therefore refutes the idea that taxable capacity depends only on taxable income, i.e. the surplus of income after subtracting tax reliefs.[557]

HM Treasury supports the use of structural reliefs to promote vertical equity as follows:

"Many allowances and reliefs can reasonably be regarded (or partly regarded) as an integral part of the tax structure – called 'structural reliefs'. Some do no more than recognise the expense incurred in obtaining income. Others reflect a more general concept of "taxable capacity" – the personal allowances are a good example. To the extent that income tax is based on

[556] ibid.p.51

[557] Silverman notes, "the surplus over [tax allowances] constitutes the true taxable capacity of the individual." (Silverman, op.cit.(note43), p.74)

ability to pay, it does not seek to collect tax from those with the smallest incomes."[558]

To promote equity, structural reliefs should be introduced to achieve both vertical and horizontal equity. If structural reliefs could be applied to achieve vertical equity, they would be consistent with the assumptions under (a) and (b) as noted in 2.2. Meanwhile, if structural reliefs could be applied to achieve horizontal equity, they would be consistent with the assumption under (c) as noted in 2.2.

Another objective of tax reliefs is to encourage particular types of individual or activity which governments favour. Tax reliefs used for this are non-structural elements of the PIT (i.e. tax reliefs which deviate from generally accepted tax structure).

According to the OECD, the widely accepted tax structure includes "the rate structure, accounting conventions, the deductibility of compulsory payments, provisions to facilitate administration and those relating to international fiscal obligations."[559] According to Willis and Hardwick, the structural elements of the PIT include "the graduation of the tax, the single and married personal allowances and the child allowance, and double taxation relief."[560]

Non-structural reliefs that are introduced to benefit certain individuals are also known as "tax expenditures." This is because they are designed to reduce tax burdens and are equivalent to cash payment made out of general tax revenue. The Inland Revenue and HM Treasury support this conclusion as follows:

> "The effect of some reliefs is to help or encourage particular types of individuals, activities, or products. Such reliefs are often alternatives to public expenditure and have similar effects. They are therefore called 'tax expenditures.' "[561]

To achieve equity, tax expenditures designed to reduce the tax burden on high-income groups should be reduced. Meanwhile, those designed to reduce the tax

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[558] HM Treasury, Tax Ready Reckoner and Tax Reliefs, http://www.treasury.gov.uk/pbr2000/tax-ready.pdf, 2.
[559] OECD, Tax Expenditures: Recent Experiences (Paris: OECD, 1996), 9.
[560] J R M Willis and P J W Hardwick, Tax Expenditures in the United Kingdom (London: Heinemann Educational Books, 1978), 10.
[561] Inland Revenue, op.cit.(note554), p.5; and HM Treasury, op.cit.(note558), p.2

burden on low-income groups should be promoted, which are consistent with the assumptions under (a) and (b), as noted in 2.2.

2.2.2 Structural reliefs

Personal allowances and expenses of earning income could promote equity, if they were designed to achieve both horizontal and vertical equity.

2.2.2.1 Personal allowances[562]

Under Thai law, personal allowances are those for (a) the taxpayer ("the basic allowance"), (b) the taxpayer's spouse, and (c) the taxpayer's lawful or adopted children, including lawful children of the taxpayer's spouse.[563] These allowances will be deducted from the taxpayer's assessable income, after the subtraction of deductible expenses, to arrive at net/taxable income.

Meanwhile, personal allowances under UK law include those for (a) taxpayers aged under 65 ("the basic allowance")[564], (b) taxpayers aged 65-74 ("the age-related allowance")[565], (c) taxpayers aged 75 or over ("the age-related allowance")[566], (d) married couples where either spouse was born before 6th April 1935 ("the married couple's allowance")[567], and (e) blind persons ("the blind person's allowance").[568]

Horizontal equity can be achieved to a large extent via personal allowances because they reduce the income-tax base of people with the same taxable capacity by the same amount. (At least if taxable capacity is measured by income.)

Under Thai law, for the tax year 2005, every taxpayer can claim the basic allowance of 30,000 baht. A group of taxpayers whose taxable capacity is reduced in the same way by marriage can claim an allowance of 30,000 baht for the spouse in addition to the basic allowance, provided that the spouse does not earn, or earn but

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562 Personal allowances that will be discussed in this subsection are the basic allowance, age-related allowances, allowances for married couples, the blind person's allowance, and allowances for children. Reasons for discussion can be found in **Appendix III to Chapter Five**.
563 Section 47, RCT
564 Section 257(1), TA1988
565 Section 257(2), TA1988
566 Section 257(3), TA1988
567 Section 257A, TA1988
568 Section 265, TA1988

elect not to file a separate tax return.[569] A group of taxpayers whose taxable capacity is reduced in the same way by raising children can claim an allowance of 15,000 baht for each child, up to a maximum of three children.

Meanwhile, under UK law, every taxpayer aged under 65 receives the basic allowance of £4,745 for the tax year 2004-05. Those whose taxable capacity is reduced in the same way by age can claim an allowance of £6,830 (for those aged 65-74) or of £6,950 (for those aged 75 or over). Taxpayers whose taxable capacity is reduced by blindness are entitled to a special allowance of £1,560 above the basic allowance.

However, personal allowances achieve vertical equity to some extent. One way to promote vertical equity is to reduce the tax burden on people with less taxable capacity. However, as we shall see later, there are three main factors preventing the operation of personal allowances from achieving desired equity.

Basic allowance

This allowance is found in both Thai and UK laws. It helps remove the lowest group on the income scale from the PIT system. Additionally, the basic allowance helps low-and middle-income earners pay less tax. Example 3.3 in **Appendix IV to Chapter Three** helps illustrate this point.

Age-related allowance

This allowance helps reduce the tax burden on the elderly, who are likely to have less taxable capacity than the young. As noted in Chapter One, personal factors, such as age, can determine differences in taxable capacity. Older people have less earning capacity than younger people because the former are generally less able to work and tend to be unemployed. Additionally, even with the same income, future earning opportunities differ between these two groups. Thanapornpan supports the view that taxable capacity depends not only on income at present but also on opportunity to earn in the future.[570] Therefore, the amount of tax paid by older people should be less than that paid by younger people. UK law via the age-related allowance helps achieve this by allowing older people to deduct a higher personal allowance than younger people.

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[569] Election to file a separate tax return by the spouse will be discussed in Chapter Four.
[570] Thanapornpan, op.cit.(note478), pp.212-213

The above argument refutes Brunori's idea. Brunori writes, "[tax preferences for senior citizens] are a stark indication of the horizontal inequities of the tax."[571] According to this statement, age should not make a difference in taxable capacity between people with the same income.[572] It can be argued against Brunori that tax preferences or age-related allowances for the elderly actually bring about:

(a) horizontal equity between people with the same income and the same age, and

(b) vertical equity between people with the same income but different taxable capacity on the basis of age.

Additionally, according to UK law, where the taxpayer's total income exceeds an income limit (£18,900 for 2004-05), the amount of age-related allowance (£6,830 for those aged 65-74, or £6,950 for those aged 75 or over) is reduced by one-half of the excess of income limit. However, the age-related allowance will not be reduced below the basic allowance (£4,745).[573] Example 3.4 in **Appendix IV to Chapter Three** helps illustrate this point.

The age-related allowance is designed to help only people of "limited means."[574] This allowance should therefore be phased out when an older taxpayer's total income increases. The age-related allowance and the income limit both promote vertical equity because the former helps reduce the tax burden on people with less taxable capacity; whilst the latter does not encourage people with greater taxable capacity to pay less in tax.

Allowance for a spouse

This allowance is found in Thai law. Personal circumstance, such as marital status, can determine differences in taxable capacity in addition to income. As we shall see in Chapter Four, a married couple is likely to have less taxable capacity than a single person with the same income. This allowance helps reduce the tax burden on a married couple.[575]

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[571] Brunori, op.cit.(note261), p.196
[572] ibid.p.196
[573] Section 257 (5), TA1988
[574] Anthony Foreman and Gerald Mowles, Zurich Tax Handbook 2002-03 (Harlow: Pearson Education Limited, 2002), 220.
[575] The allowance for a spouse will be discussed in Chapter Four.

Married couple's allowance (the "MCA")

This allowance is found in UK law. However, the MCA for younger couples was abolished from 6th April 2000. It is still available for older couples who are a needy group and have less taxable capacity.[576]

Blind person's allowance

This allowance is found in UK law. It helps reduce the tax burden on blind persons who are likely to have less taxable capacity than the sighted with equal incomes. Personal factors, such as handicap, can determine differences in taxable capacity in addition to income. The blind have less taxable capacity than the sighted because in general, they are unable to work well and tend to be unemployed. Therefore, the blind should pay less tax than the sighted even with the same income in the current year. This allowance helps the blind to deduct a higher allowance than the sighted; consequently, the blind have less taxable income and pay less tax. This allowance then promotes vertical equity.

However, it is argued against the blind person's allowance as follows:

> "[Firstly,] the blind who pay income tax benefit from the deduction, but not those below the tax threshold. Secondly, it does not seem equitable to favour the blind and not the deaf, paralysed, or other handicapped people."[577]

Blind people below the tax threshold have less taxable capacity than those above the threshold. Although the former do not benefit from this allowance, they do not pay tax as a result of the basic allowance; whereas the latter are still required to pay tax because the basic allowance cannot move them from the tax net as in the case of the former. The blind person's allowance is the raising of the tax threshold for the blind. This can further move the blind from the tax net or help them to pay less tax. This is reasonable when comparing the blind and the sighted.

As regards the second argument, I agree that there should be a similar additional allowance for people who suffer any other disability.

Allowance for children

This allowance is found in Thai law. It helps reduce the tax burden on people with dependent children. Personal circumstance, such as family responsibility, can

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[576] The MCA will be discussed in Chapter Four.

determine differences in taxable capacity in addition to income. People with a number of dependent children have greater family expenditure than those with no or few children. Thus, raising children reduces taxable capacity. The former need a higher subsistence income than the latter in order to raise children.

The allowance for children under Thai law helps a couple or individual with dependent children to deduct a higher allowance than a couple or single person without children; the former have less taxable income and pay less tax than the latter. This allowance thus promotes vertical equity. Conversely, the help for people with dependent children under UK law is not in the form of a tax allowance; but in the form of a social security benefit called "child tax credit."[578]

Schnitzer notes that "[family allowances] tend to redistribute income from small to large families" who have the same income.[579] This implies that where two families with the same income pay different tax as a result of the allowance for children which increases as the size of the family increases, this brings about "horizontal redistribution" in Schnitzer's words.[580] Similarly, this allowance encourages income redistribution among members of the same income class, not among different income classes. It seems that (a) this allowance leads to horizontal inequity, and (b) it does not correspond with the concept of vertical equity. Similarly, Steinmo notes that "deductions for dependents" affects "the real progressivity of the tax code."[581] This argument can be dismissed on the following grounds.

A family with a number of children has higher family expenditure and needs a higher subsistence income than one with few children. Thus, although two families have the same income, they have different taxable capacity, i.e. the former has less taxable capacity than the latter. When the allowance for a child means the former pays less tax than the latter, (a) it does not lead to horizontal inequity, and (b) it corresponds with the concept of vertical equity.

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[577] N.A.Barr et al., Self-Assessment for Income Tax (London: Heinemann Educational Books, 1977), 16.
[578] Morse and Williams note that child tax credit (CTC) could be described as "child benefit plus" and is "additional payment to go with the child benefit payable for a child and payable to the same person that claims the child benefit for that child [;] the difference is that child benefit is a universal flat-rate weekly benefit, while CTC is income-based, adjusted to specific circumstances of the child and claimant, and payable for a tax year." (Morse and Williams, op.cit.(note15), p.169)
[579] Schnitzer, op.cit.(note22), p.192
[580] ibid.p.192

Altogether, personal allowances satisfy the ability-to-pay principle by reducing the tax burden on people with less taxable capacity. However, they cannot achieve the desired equity of income redistribution because of:

(i) the amount of personal allowances,

(ii) the progressive rate structure, and

(iii) the adjustment of personal allowances in line with price inflation.

(i) and (ii) The amount of personal allowances and the progressive rate structure

One approach to make the PIT system more progressive is to increase the personal allowances further to reduce the tax burden on low-income earners (or "raising the tax threshold.")

Various countries have experimented raising the tax threshold to protect the poor. In the UK, "from 1979 to 1997...important changes to the structure helping the poor were made but were general – lowering the rate of tax, ...and raising the tax threshold."[582] However, Marshall notes one disadvantage from this experiment as follows:

> "Raising the tax threshold takes some income earners out of the income tax net, but it does nothing positive to improve the relative positions of those whose earned incomes are initially too low to be liable for income tax."[583]

Although raising the tax threshold does not benefit lowest-income earners, it can benefit low-income earners. Raising the tax threshold can eliminate all low-income earners, or move some of them from the tax net and further reduce the tax burden on other low- and middle-income earners. Therefore, raising the tax threshold corresponds with one side of the concept of progressivity to reinforce equity. When we look at the concept of progressivity from the lower end of the income scale, this concept requires a smaller proportion of income to be taken in tax from those with less taxable capacity.

From the above, this research supports raising the tax threshold to benefit low- and middle-income earners for the purpose of equity, provided that this raising

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[581] Sven Steinmo, Taxation and Democracy, (New Haven: Yale University Press, 1993), 37.
[582] Tiley, op.cit.(note141), p.8
[583] Marshall, op.cit.(note31), p.361

is optimal. A further point to be examined is how high the tax threshold should be raised. The World Bank proposes the following:

> "To relieve the tax burden on the poor, a portion of household income, approximately equivalent to per capita GDP (and up to twice per capita GDP where income tax administration is not well developed), can be exempted from the base of [the PIT]."[584]

Lent and Hirao note that "personal allowances serve in part a useful function in protecting living standards"[585]; and "the general level of the allowances should be governed primarily by the cost of a reasonable standard of living."[586] Likewise, personal allowances are given to leave a subsistence income to individuals before they pay the tax, and the amount of personal allowances should correspond to the real cost of a standard of living.[587]

The basic allowance under Thai law has been 30,000 baht since 1992. Meanwhile, the per capita GDPs in Thailand in 1999, 2000, 2001, 2002 and 2003 were 75,026, 79,098, 81,915, 86,249 and 93,164 baht respectively.[588] Additionally, average monthly expenditure per capita in 2004 was 3,512 baht[589] (42,144 baht per year). Meanwhile, private consumption expenditure per capita in 1999, 2000, 2001, 2002 and 2003 was 41,988 baht, 44,394 baht, 46,930 baht, 49,309 baht and 52,794 baht respectively.[590] These data show that the basic allowance is lower than the above amounts.

This research proposes that the basic allowance should be increased to 45,000-55,000 baht. This increased amount is likely to cover private consumption expenditure per capita representing the cost of living in 2005. The allowance for a spouse should also be increased to 45,000-55,000 baht (equivalent to the basic allowance). And the allowance for children should be increased to 22,500-27,500 baht for each child (half of the adult's allowance). According to the National

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584 The World Bank, op.cit.(note112), p.6
585 Lent and Hirao, op.cit.(note185), p.30
586 ibid.p.30
587 Dhiratayakinant, op.cit.(note476), p.101
588 **Source**: Office of the National Economic and Social Development Board, http://www.nesdb.go.th/econSocial/macro/gpp_data/index.html,as of 22/07/ 2005
589 **Source**: The National Statistical Office of Thailand, op.cit.(note259) (Table 7.1 Average Monthly Income and Expenditure by Region 2004), p.172

Statistical Office of Thailand, consumption expenditure includes "the amount spent on purchasing goods and services needed for living essentials."[591]

Therefore, these proposed amounts are likely to correspond to the real cost of a standard of living, which would further move some low-income earners from the tax net.

As this research agrees that the amount of the basic allowance should be tied to the cost of living, the basic allowance under UK law should not be below private consumption expenditure per capita. According to a report on the 2002-03 Expenditure and Food Survey,[592]average weekly expenditure on commodities and services per person was £170.50[593] (£8,866 per year). According to this report, average weekly expenditure on commodities and services per person in the lowest income decile group was £106[594](£5,512 per year). From these data, the basic allowance should be in the range between £5,500 to £9,000 in the tax year of 2004-05. However, Saatchi and Warburton argue that there should be a significant increase in the basic personal allowance.[595] They note that the amount of the basic personal allowance should be related to average earnings and yet this amount is actually lower than average earnings.[596] They then propose as follows:

> "The personal tax threshold for 2000-01 was £4,385. Over the past 50 years this threshold has dropped lower and lower in relation to average earnings. For a single person, it would need to be £6,200 in the tax year 2000-01 to restore the value that it had in 1950."[597]

Nevertheless, they argue that the basic allowance should have been increased to £10,000 in 2000-01. This significant increase would help 8,000,000 low-income

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[590] ibid. (Table 9.1 National Income, Gross National Product and Consumption Expenditure:1999-2003), p.198
[591] ibid.p.168
[592] Expenditure items are similar to items under consumption expenditures in Thailand.
[593] **Source**: The Office for National Statistics, Family Spending: A report on the 2002-03 Expenditure and Food Survey, Anthony Craggs, ed., (London: TSO, 2004), 15.
[594] ibid.p.14
[595] Maurice Saatchi and Peter Warburton, Poor People Stop Paying Tax: The War of Independence: A Call to Arms (London: Centre for Policy Studies, 2001), 12.
[596] ibid.p.12
[597] ibid.p.12

earners not to pay income tax.[598] Additionally, it would simplify the overlap between complicated systems of tax and benefits. As they write,

> "Higher net incomes [as a result of higher personal allowances] reduce the need for government benefit payments, because people no longer qualify for means-tested benefits. The motivations for millions of minor tax and benefit transfers would simply disappear."[599]

Despite agreement about raising the tax threshold to help the poor, this research and Saatchi and Warburton have a different view on the level of rise. The question then arises as to which level is optimal, (a) raising the tax threshold to meet the real cost of living or (b) a significant increase in the basic allowance. This is because a significant increase will lead to greater loss of tax revenue than an increase to meet the real cost of living. Additionally, a significant increase will considerably reduce tax progressivity when we look at the concept of progressivity from the upper side of the income scale.

Despite causing a reduction in the tax burden on low-income earners, both existing and higher personal allowances can also reduce the tax burden on higher-income earners. A reduction in the tax burden on high-income earners reduces tax progressivity, and a reduction in tax progressivity depends on the amount and increase of personal allowances. The higher the tax threshold, the lower the taxable income and ATRs of high-income earners. Additionally, the progressive rate structure helps higher-income earners to gain more tax benefit (or a larger proportionate reduction in the tax burden) from higher personal allowances than lower-income earners. (Example 3.5 in **Appendix V to Chapter Three** help clarify these points.) Hence, the progressive rate structure is another factor that prevents the operation of personal allowances from achieving desired equity.

This research so far shows two opposing views of the effect of increasing personal allowances. The first is that an increase in the personal allowance reduces the tax burden on low-income earners, which makes the tax more progressive and reinforces equity. The second is that a higher personal allowance reduces tax progressivity and prevents equity because the allowance increase gives more benefits

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598 ibid.p.12
599 ibid.p.4

(or a higher proportionate reduction in the tax burden) to higher-income earners than to lower-income earners. Neither of them is completely true.

The first view disregards the tax benefits accruing to high incomes, whereas the second disregards the tax benefits accruing to low incomes. Tax progressivity must serve both lower and upper ends of the income scale, i.e. reducing the proportion of income paid in tax by lower-income taxpayers and increasing the proportion of income paid in tax by higher-income taxpayers. Thus, it is necessary to seek a method to satisfy this idea of progressivity for desired equity.

Other methods are proposed or used to protect low incomes in place of personal allowances. Stotsky refers to one proposal for tax credits as follows:

> "Some tax codes have converted [personal allowances] into a credit against taxes to enhance the equity of the tax system because a credit reduces the tax burden by the same nominal amount regardless of the taxpayer' s [MTR]."[600]

Although tax credits can protect the poor and not allow the rich to gain more tax benefits than the poor, the rich can still receive tax benefits. This does not conform to the idea of progressivity (which partly requires an increase in the tax burden of the wealthier).

The OECD refers to another proposal for a zero-rated first bracket as follows:

> "In some countries, the basic relief takes the form of a zero-rated first bracket. ... In some circumstances the effect of substituting a zero rate in the first bracket is to produce the same effect as giving a tax credit. But the extension of an existing zero-rate bracket produces the same result as increasing a tax allowance (i.e. it gives greater relief to top-rated taxpayers than to those whose highest rate is at the lower end of the scale) unless the extension is balanced by a reduction of the next higher bracket or brackets. "[601]

The IMF proposes that Thailand should replace personal allowances with a zero-rate bracket. It writes,

> "The effective threshold should be significantly increased compared to the present level. The increased threshold could most conveniently be

[600] Stotsky, op.cit.(note509), p.123
[601] OECD, op.cit.(note70), p.21

implemented through a zero-rate bracket comprising, say, the first Baht 100,000 of income. This would effectively eliminate the need for all low income individuals and families to file a return."[602]

However, although a zero-rate bracket works like a tax credit, the rich can still receive tax benefits. Additionally, the extension of a zero-rate bracket is more valuable to the rich than to the poor. Although there is a solution to prevent the rich from receiving more benefit from the extension, the rich can still receive tax benefits.

Altogether, tax credits and a zero-rate bracket cannot work much better than personal allowances. To satisfy the concept of progressivity which requires a reduction in poorer taxpayers' liabilities and an increase in richer taxpayers' liabilities, this research proposes the following:

(a) maintaining personal allowances,
(b) increasing personal allowances to cover private consumption expenditure per capita, and
(c) cancelling or phasing out personal allowances for the rich.

The reason for maintaining personal allowances is that it can be designed and applied to satisfy the ability-to-pay principle to achieve horizontal and vertical equity. If personal allowances were increased further to reduce the tax burden on low-income earners (not on high-income earners), they would promote vertical equity and make the tax more progressive.[603] This would achieve the desired equity.

The first personal allowance which should be increased in value is the basic allowance. The other allowances should be increased thereafter. The optimal level of basic allowance is one which can meet the real cost of living standard, which is likely to be per capita private consumption expenditure. Nevertheless, the existing personal allowance and its modest increase to reach the cost of living cannot avoid giving tax benefits to the rich. This is because the allowance is available to everybody.

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[602] George T. Abed et al., Thailand: Improving the Structure and Performance of the Revenue System (Washington, D.C.: Fiscal Affairs Department, International Monetary Fund, 1998), 62.

[603] An increase in personal allowances only for low-income earners will have the following effects:

(a) helping them to pay much less income in tax than high-income earners, which promotes vertical equity; and
(b) helping them to pay a much smaller proportion of income in tax than high-income earners, which makes the tax more progressive.

Tax benefits resulting from the allowance (which reduces taxable income subject to the progressive rate structure) cause the rich not to pay the higher amount and proportion of income in tax. This probably increases the economic power of the rich, which will increase the income gap between rich and poor. This violates tax progressivity which needs to take a greater amount and proportion of income from the rich. Given this, the allowance does not work exactly like the progressive tax rate. The operation of progressive tax rate conforms to the concept of progressivity, by applying lower rates for low-income earners, and higher rates for high-income earners. Thus, the allowance should also be reformed on the upper side of the income scale to work like the progressive tax rate. The proposed reform is that the allowance should stop giving tax benefits to the rich. This reform can be made by cancelling or phasing out personal allowances for this group.

The result of this would be an increase in the tax burden on high-income earners, satisfying the ability-to-pay principle and the concept of progressivity.[604] Likewise, this result would achieve desired equity because it ceases to contribute to widening the gap between rich and poor through personal allowances. Dhiratayakinant seems to support this argument. He notes that the tax system can be designed to counter income inequality by not encouraging high-income groups to increase their income greatly.[605]And this is a better tax measure for reducing income inequality than taxation based on highly MTRs.[606]

Moreover, denying tax benefits to the rich through personal allowances seems to achieve the real objective of personal allowances: that is, ensuring that those with less taxable capacity have a subsistence income before any tax is paid. This inference is drawn from both the outright and the partial views of policy makers and scholars.

The outright view includes those of HM Treasury, Dalton, Pond, Richupan and Dhiratayakinant. HM Treasury states that personal allowances "reflect a more general concept of taxable capacity", and "to the extent that income tax is based on

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[604] Canceling or phasing out personal allowances only for the rich will have the following effects:
(a) causing the rich to pay a much greater amount of income in tax than the poor, which satisfies the ability-to-pay principle and promotes vertical equity; and
(b) causing the rich to pay a much greater proportion of income in tax than the poor, which satisfies the concept of progressivity on the upper side of the income scale.

[605] Kraiyudht Dhiratayakinant, Public Economics: Volume one Fiscal and Tax Systems (Bangkok: Chulalongkorn University, 2002), 1.1-32.

[606] ibid.p.1.1-32

ability to pay, it does not seek to collect tax from those with the smallest incomes."[607] As Dalton notes, it is "a system of exemptions and allowances ...principally affecting the smaller incomes."[608] Pond also notes that in the UK, personal allowances "are intended to exempt those on the lowest incomes from tax altogether."[609] Likewise, Richupan states that, "the deduction of allowances is an adjustment of the tax base, for equity purposes, that takes into account the maintenance expenditure for the taxpayer's family."[610] He also notes elsewhere that allowances are given to take low-income earners out of the tax net.[611] Dhiratayakinant argues that allowances are given to exempt people with high family expenditure and small gross incomes from tax.[612]

Meanwhile, there is a view that the objective of personal allowances is to relieve the tax burden on individuals based on personal circumstances. This view is found in the statements of former and present Thai tax policy-makers[613] and may be influenced by the wording of the RCT.[614] Likewise, Whitehouse notes, "the availability of [personal] reliefs [under UK law] depends not on the type of income involved, but on the taxpayer's personal circumstances."[615] Melville also says, "personal allowances [under UK law] are intended to adjust the income tax liability of a taxpayer so as to reflect his or her personal circumstances."[616]Although there is no outright expression that allowances are given to relieve the tax burden on those with less taxable capacity, it may be said that this is the hidden objective of allowances as we shall see below.

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[607] HM Treasury, op.cit.(note558), p.2
[608] Dalton, op.cit.(note30), p.95
[609] Chris Pond, "Tax Expenditures and Fiscal Welfare", Taxation and Social Policy, Cedric Sandford, Chris Pond and Robert Walker (London: Heinemann Educational Books Ltd., 1980), 53.
[610] Richupan, op.cit.(note512), p.30
[611] Somchai Richupan, "Problems and Proposals on the Reform of Personal Income Tax", RD Tax Journal, Year No.29, Issue No. 2, March-April, 1982, 42.
[612] Dhiratayakinant, op.cit.(note476), p.117
[613] Paichit Rojanavanich et al., Taxes under Revenue Code (Abridged Version) (Bangkok: Samchareon-pranich (Bangkok) Co., Ltd., 2001), 28; and Vit Tantayakul, Revenue Law (Publisher and Year of Publication not identified), 70.
[614] According to Section 40 of the RCT, the deduction of allowances is made to relieve tax burdens on individuals.
[615] Chris Whitehouse, Revenue Law: Principles and Practice, 17th ed. (London: Butterworths, 1999), 56.
[616] Melville, op.cit.(note541), p.31

The personal circumstances to which personal allowances are applied are mostly related to those of people with less taxable capacity, i.e. poverty, old age, handicap, and marital and family status. Because of these circumstances, the provision of subsistence income in the form of personal allowances is made by the tax law to help people in such circumstances. Simultaneously, wealthy taxpayers have income far beyond subsistence; therefore, they are not people in need of that. Given this, the law is unlikely to have an intention to help wealthy taxpayers, but to help the poor and other people in need instead. This inference means that the objective of personal allowances will correspond to one of the main objectives of the PIT.[617]

To implement the proposed reform, the following changes in the system of personal allowances in question may be considered.

Under Thai law, people with gross/assessable incomes not exceeding the amount representing the incomes of low-income and (lower) and (upper) middle-income earners (e.g.1,000,000 baht), would still receive all existing personal allowances. People with gross/assessable incomes not exceeding the amount representing the incomes of high-income earners (e.g.1,000,000-4,000,000 baht) would receive half of all existing personal allowances. People with gross/assessable incomes exceeding the amount representing the incomes of highest-income earners (e.g. over 4,000,000 baht) would not receive any existing personal allowances.

Under UK law, people aged under 65 with a total income not over the amount representing the incomes of low-income and (lower) and (upper) middle-income earners (e.g. £20,445 in 2004-05)[618], would still receive the basic allowance. (In cases where people are blind, they would receive the blind person's allowance in addition to the basic allowance). People aged under 65 with a total income not over the amount representing the incomes of high-income earners (e.g. £20,445-36,145)[619], would receive half the basic allowance. (In cases where people are blind, they would receive the blind person's allowance and the basic allowance. This is because the blind have less taxable capacity than the sighted). People aged under 65

617 Income redistribution is made from the wealthy to people in need.
618 This is the basic allowance (£4,745) plus the first half of the basic-rate limit (£15,700).
619 This is the amount above the basic allowance plus the first half of the basic-rate limit but not over the amount of the basic allowance plus the second half of the basic-rate limit

with an income above a certain amount representing the incomes of highest-income earners (e.g. £36,145)[620], would not receive the basic allowance. (In cases where people are blind, they would receive half the basic allowance and the blind person's allowance. This is because the blind have less taxable capacity than the sighted).

People aged 65-74 with a total income below £38,230 in 2004-05[621] would still receive the age-related allowance. (In cases where people are blind, they would receive the blind person's allowance in addition to the age-related allowance). In cases where people aged 65-74 had a total income exceeding the income limit, £18,900 in 2004-05 but not over £38,230 in 2004-05, the age-related allowance (£6,830) would be reduced by one-half of the excess limit. However, the age-related allowance would not be reduced below the basic allowance (£4,745). (In cases where people are blind, they would still receive the blind person's allowance). Meanwhile, people aged 65-74 earning over £38,230 would not receive the age-related allowance, but would receive half the basic allowance. This is because older people have less taxable capacity than younger people. (In cases where people are blind, they would receive the blind person's allowance in addition to half the basic allowance).

People aged 75 or over with a total income below £38,350 in 2004-05[622] would still receive the age-related allowance. (In cases where people are blind, they would receive the blind person's allowance in addition to the age-related allowance). In cases where people aged 75 or over had a total income exceeding the income limit, £18,900 in 2004-05 but not over £38,350 in 2004-05, the age-related allowance (£6,950) would be reduced by one-half of the excess limit. However, the age-related allowance would not be reduced below the basic allowance (£4,745). (In cases where people are blind, they would still receive the blind person's allowance). Meanwhile, people aged 75 or over earning over £38,350 would not receive the age-related allowance, but would receive half the basic allowance. This is because older people have less taxable capacity than younger people. (In cases where people are blind, they would receive the blind person's allowance in addition to half the basic allowance).

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[620] This is the amount over the basic allowance plus the basic-rate limit (over £4,745+31,400).
[621] This is the amount of the age-related allowance (£6,830) plus the basic-rate limit (£31,400).

(iii) Adjustment of personal allowances in line with price inflation

Personal allowances might not entirely achieve equity if they failed to keep up with price inflation. This is because price inflation reduces the real value of personal allowances, and it puts a greater tax burden on low-income earners.

The cost of living normally increases with price inflation. As discussed earlier, personal allowances are primarily given to cover the cost of living. If personal allowances were not increased in line with price inflation, they could not cover the real cost of living. In this situation, low-income earners and people receiving a number of allowances (e.g. those having dependent spouses and children) suffer most. Therefore, personal allowances should be adjusted for price inflation to cover the cost of living.

Money income tends to rise with price inflation.[623] In cases where earnings increase with price inflation but personal allowances do not rise for price inflation, a heavier tax burden will fall on low-income earners. This is because under this situation, some low-income people who are below the tax threshold before price inflation are pushed past the tax threshold into the starting-rate band after price inflation. Others who are already in the starting-rate band before price inflation are pushed into higher tax liability after price inflation. Under this situation, the tax burden on low-income earners was increased because of increases in their nominal not their real incomes accompanied by the unchanged nominal value of their allowance. (Musgrave points out that ability to pay relates to "real rather than nominal income.")[624] Consequently, both vertical equity and tax progressivity (which partly requires lower-income earners to pay a less amount and a smaller proportion of income in tax) are affected. Therefore, the nominal values of allowances should be raised in line with price inflation to avoid this phenomenon. Example 3.6 in **Appendix VI to Chapter Three** will clarify these points.

The question then arises as to how personal allowances can be increased with price inflation. We have seen that these are given to cover the cost of living, which rises with price inflation. The rate of price inflation and the cost of living are

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[622] This is the amount of the age-related allowance (£6,950) plus the basic-rate limit (£31,400).

[623] Kovit Posayanon, "A change in tax revenue during the period of economic development", RD Tax Journal, Year No.44, Issue No. 9, September, 1997, 69.

measured by the retail prices index or the consumer price index.[625] Therefore, to keep pace with the rate of price inflation and to maintain real value to cover the cost of living, the nominal value of allowances should be adjusted annually in line with changes in the retail prices index.

Personal allowances can be increased with wage inflation. However, we are unlikely to annually adjust the nominal value of allowances in line with the rate of wage inflation. It is unusual to measure the rate of wage inflation or "to index link wage rates" because "changes in supply and demand in the labour market make it desirable for wage rates to be more flexible."[626]

According to UK law, unless Parliament determines otherwise, the amount of the basic allowance, age-related allowances, married couple's allowances for older couples and the blind person's allowance are increased annually by the same percentage as the percentage increase in the retail prices index for the previous year.[627] Therefore, UK law promotes tax progressivity and vertical equity.

However, the basic allowance for 2003-04 remained at the same amount as that for 2002-03. This freezing has intensified "fiscal drag."[628] This unchanged nominal value causes a higher portion of nominal income to be subject to higher tax liability, which can increase the tax burden on the poor.

Unlike UK law, Thai law has no provision to index personal allowances for price inflation. The Thai government has a policy on the adjustment of personal allowances from time to time to mitigate the tax burden due to the higher cost of living and change in labour costs.[629] However, judging from Thailand's experience, occasional changes in the nominal values of allowances are not good enough to maintain their real values. According to Sahasakul,

> "[Price] inflation has reduced the real value (in 1972 prices) of a personal exemption from 4,000 baht in 1972 to 2,778 baht in 1978 in spite of the

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[624] R.A. Musgrave, "Taxation", The New Palgrave: A Dictionary of Economics, John Eatwell, Murray Milgate and Peter Newman, eds. (London: The Macmillan Press Limited, 1987), 1058.

[625] Bannock, op.cit.(note249), p.359; and Black, op.cit.(note140), p.404

[626] Nancy Wall, Complete A-Z Economics Handbook, 2nd ed. (London: Hoddler &Stoughton, 2003), 149.

[627] Sections 257C and 265 , TA1988

[628] Author not identified, "Taxation: Truth hurts", The Economist, Vol. 367, No. 8330, June 28th, 2003, 41.

government's raising the nominal value of the personal exemption to 5,000 baht since 1974. In 1979, the nominal value of the personal exemption was raised to 7,000 baht but its real value was still below 4,000 baht."[630]

Similarly, a significant increase in allowances in 1980 was not "adequate to keep up with [price] inflation."[631] Also, Chandra-ruang-phen and Sayakanit find that despite increases in allowances in 1972, 1974 and 1978, the proportionate increases were lower than the proportionate increases in the consumer price index.[632] Their conclusion is consistent with my earlier analysis. As they say, allowances grew more slowly than the real cost of living, resulting in a reduction in their real value.[633]

Additionally, the Thai government increased the nominal value of allowances constantly before 1992. However, as Table 3.1 shows, there has not been an increase in allowances since 1992, although price inflation has occurred every year during this period. As noted in Chapter Two, the rates of price inflation from 1992-2004 were 4.1%, 3.4%, 5.1%, 5.8%, 5.9%, 5.6%, 8.1%, 0.3%, 1.6%, 1.6%, 0.7%, 1.8%, and 2.7%respectively.

Table 3.1[634]

Personal Allowances	1972-1973	1974-1978	1979	1980-1981	1982-1984	1985-1988	1989-1990	1991	1992-at present
For the taxpayer	4,000	5,000	7,000	10,000	12,000	13,000	15,000	20,000	30,000
For taxpayer's spouse	4,000	5,000	7,000	10,000	12,000	13,000	15,000	20,000	30,000
For each lawful child	1,000	2,000	3,000	5,000	5,000	6,000	7,000	10,000	15,000

The Thai tax policy cannot deal with the impact of price inflation on the tax burden of the poor. The OECD notes, "a policy of not adjusting thresholds for [price]inflation may have…unintended effects in relation to the poverty trap."[635] It is therefore advisable to adopt provisions for price-level indexation into Thai law. The World Bank supports this suggestion as follows:

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[629] The group of Thai tax academicians, Taxation According to Revenue Code 2002 (Bangkok: Ruan-Gaow Printing, 2002), 39.
[630] Sahasakul, op.cit.(note257), p.30
[631] Richupan, op.cit. (note512), pp.52-53
[632] Chomploen Chandr-ruang-phen and Ratana Sayakanit, The Thai Tax Structure and Its Effects on Economic Development (Bangkok: Chulalongkorn University, 1981), 106.
[633] ibid.p.106
[634] **Source**: The group of Thai tax academicians, op.cit.(note629), cover page
[635] OECD, op.cit.(note70), p.42

"[In Thailand], there are no automatic adjustments of ...monetary allowances, so the inflationary effect on ...thresholds has gradually eliminated much of [tax progressivity]. .... Also, consideration should be given to creating an automatic inflation adjustment methodology to update ...thresholds in the PIT."[636]

2.2.2.2 Deductible expenses

The costs of earning income are regarded as structural reliefs. Both Thai and UK laws allow taxpayers to claim certain expenses against assessable income from particular sources to determine income.[637]

To satisfy the ability-to-pay principle, income should be determined net of the costs of obtaining that income. Similarly, "only income *net of business expenses* increases potential consumption power."[638] Consequently, a person who has an outlay to obtain income has less economic and taxable capacity than another who earns an equal income with less or no outlay.

Both Thai and UK laws adopt the above concept. According to these, among three people with equal income, a self-employed person or a business owner claims greater deductible expenses than another who is a wage-earner.[639] A person with investment income however is not entitled to deductible expenses. It is assumed that (a) the self-employed incur more expenses in connection with their income than wage-earners, and (b) people with investment income are unlikely to incur expenses in respect of this income. Thuronyi points out that:

"[The] nature of employment is such that the costs incurred by employees are relatively small, given that the employer provides the conditions for work. It

[636] The World Bank, op.cit.(note262), p.27

[637] Expenses will be deducted from assessable income before subtracting other deductions and allowances.

[638] Rosen, op.cit.(note250), p.341

[639] Under Thai law, people with self-employment or business income can claim actual expenses or standard deductions without a maximum limit. Meanwhile, employees can claim only a standard deduction with a maximum limit.

Under UK law, Melville notes, "a much wider range of expenses is allowed against the income of self-employed people than against the income of employees." (Melville, op.cit., p.82) is therefore less critical (in terms of tax equity) to allow a deduction for employee expenses than it is for the self-employed."[640]

James and Nobes support assumption (b) stating that "the favourable treatment of earned income is that there are expenses incurred in obtaining it which are greater than those incurred in obtaining investment income."[641]

Although Thai and UK laws adopt the same principle of deductible expenses, how they determine expenses against assessable income is not the same in every respect. Under Thai law, there are (a) a standard deduction (i.e."a fixed percentage deduction")[642], and (b) a deduction of actual expenses (i.e. a deduction of necessary and reasonable expenses incurred in obtaining income).[643] UK law principally applies a deduction of actual expenses.

Under Thai law, taxpayers can claim expenses against each category of income as follows:

(i) for income under categories (1), (2), (3) (only for copyright income), (5) (b), (5) (c), and (8) (for a particular type of income), taxpayers can claim only a standard deduction[644];

(ii) for all income under categories (3) (except for copyright income) and (4), taxpayers cannot claim any deduction as expense[645];

(iii) for income under categories (5) (a), (6), (7), and (8) (for a particular type of income), taxpayers can choose either a standard deduction or a deduction of actual expenses[646];

(iv) for income under category (8) (for a particular type of income), taxpayers can claim only a deduction of actual expenses.[647]

Additionally, the percentage of standard deduction for self-employment and business income is higher than that for employment income. For example, a

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[640] Thuronyi, op.cit.(note10), p.253
[641] James and Nobes, op.cit.(note5), p.160
[642] Ministry of Finance, Information Handbook on Taxation in Thailand, 2nd ed. (Bangkok: Thammasat University Press, 1982), 5.
[643] Sections 5, 6, 7, 8, and 8 bis., Royal Decree No.11 (1959)
[644] Sections 42 bis., 42 ter., and 48 (4) (a), RCT;
Sections 5 (2), 5 (3), Royal Decree No.11 (1959)
[645] Section 42 ter., RCT
[646] Sections 5 (1), 6, 7, and 8, Royal Decree No.11 (1959);
Section 4, Royal Decree No.165 (1986)
[647] Sections 8 bis., Royal Decree No.11 (1959)

contractor can claim a 70% standard deduction of expenses; while a wage earner can claim a 40% standard deduction but not exceeding 60,000 Baht in total. (More details can be found in **Appendix VII to Chapter Three**). This corresponds to the concept that business expenses are greater than employee expenses.

Nevertheless, it is argued that differences in the percentage of standard deduction bring about the following:

(a) unfairness/discrimination between people with different sources of income, and

(b) unfairness/discrimination between people with the same source of income.[648]

Differences in the percentage of standard deduction between income from difference sources, particularly between employment income and self-employment income, are unlikely to cause unfairness. This is because self-employed or business owners incur more expenses than wage-earners. This justification refutes both arguments above and the similar argument that standard deductions cause wage-earners to pay a higher ATR than other income earners, which creates horizontal inequity.[649]

However, differences in the percentage of standard deduction between self-employment or business income from different categories may lead to unfairness. Differences in the percentage of standard deduction between income from the same category are also likely to cause horizontal inequity. This is because taxpayers with equal income may pay different taxes. For example, between two people with equal income under the same category (3), one deriving income from the sale of authorship (copyright income) will pay less tax than another deriving income from the sale of patent rights. This is because the latter cannot claim any expense deduction, whilst the former enjoys a 40% standard deduction.

Additionally, the percentage deduction makes Thai law does not satisfy the ability-to-pay principle for three reasons.

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648 Dhiratayakinant, op.cit.(note476), p.103
649 Fugfaipon, op.cit.(note168), p.63

Firstly, standard deductions may help taxpayers to deduct expenses exceeding those actually incurred in obtaining income.[650]

Secondly, there is no sure criterion for setting the percentage of standard deduction.[651] Therefore, it is unclear why there are inconsistencies such as there being no standard deduction for income from patents, whereas there is for income from copyright.

Thirdly, Dhiratayakinant notes that the method of standard deduction assumes that all taxpayers make profits from their businesses (or, no taxpayer makes a loss in a tax year). This is illogical. In doing business, people can make either profit or loss. If a taxpayer makes a loss, he/she will not get benefit from a tax computation under the method of standard deduction.[652]

For the above reasons, taxpayers' real economic and taxable capacity are unlikely to emerge after standard expense deductions. Moreover, if higher-income taxpayers deducted expenses exceeding the real costs of earning (by applying standard deductions as expenses or choosing standard deductions in place of actual expenses), this would undermine tax progressivity and vertical equity/redistribution.

Nevertheless, a maximum limit of standard deduction for income under categories (1) (or employment income), (2) (or income from a post), and (3) (only for copyright income) can help to promote vertical equity/redistribution. Under Thai law, taxpayers who derive income under categories (1), (2) or (3) above can claim a 40% standard deduction, but they cannot deduct expenses exceeding 60,000 baht from their gross income. Therefore, the percentage of standard deduction available to them may be lower than 40%. For example, Noi derives employment income of 100,000 baht. She can claim a full standard deduction of 40% as expenses. Meanwhile, Som earns employment income of 4,000,000 baht. He can deduct only 60,000 baht as expenses because a 40% standard deduction (equivalent to 1,600,000 baht) exceeds 60,000 baht. In other words, the percentage of standard deduction that Som can claim is 1.5%, which is much lower than Noi's. Therefore, a ceiling of standard deduction helps promote vertical equity/redistribution because higher-

[650] Richupan accepts that "standard deductions are rather high." (Richupan, op.cit. (note512), p.74)
[651] Dhiratayakinant, op.cit.(note476), pp.102, and 104-105
[652] ibid.p.104

income taxpayers claim a lower percentage of deduction than lower-income taxpayers.[653]

Where there is no ceiling of standard deduction, this undermines tax progressivity and vertical equity/redistribution. This is because higher-income taxpayers receive a greater proportionate reduction in tax burden from standard deductions than lower-income taxpayers since they are subject to higher MTRs. A standard deduction reduces taxable income for both lower- and higher-income earners. A reduction in taxable income subject to the high MTR will make a greater reduction in tax burden than a reduction in taxable income subject to the low MTR. Example 3.7 in **Appendix VIII to Chapter Three** helps clarify these points.

From the above, a standard deduction is likely to dissatisfy the ability-to-pay principle and the concept of progressivity, which undermines equity. However, the Thai government has no policy to abolish the standard deduction. Instead, it has reduced the percentage of standard deductions from time to time since 1959. In 1980, Richupan, the then tax policy-maker, wrote:

> "[The] idea of standard deduction was based on the socio-economic situation in Thailand in 1959, more than 20 years ago. ...... But now we are in 1980 and the Thai socio-economic situation has substantially changed from what it was in 1959. There should now be a policy to encourage taxpayers to keep accounts. The rate of standard deduction should gradually be reduced so that it will pay for the taxpayer to keep accounts. [654]

The above recommendation is meant to encourage taxpayers to keep accounts for the deduction of actual expenses.[655] This implies that the Thai government perceives that a deduction of actual expenses is better than a standard deduction. However, the percentage of standard deduction for most categories of income has remained the same, and that for certain categories has been increased since 1980.[656] Furthermore, standard deductions have been allowed for four additional types of

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[653] Chandr-ruang-phen and Sayakanit, op.cit.(note632), p.114

[654] Richupan, op.cit. (note512), p.74

[655] Somchai Richupan, "Problems and Proposals on the Reform of Personal Income Tax", The Journal of the Revenue Department of Thailand, Year No.29, Issue No. 3, May-June, 1982, 13.

[656] For example, the percentage of standard deductions for income under categories 5, (6), (7) and (8)remains unchanged. The percentage under categories (1) and (2), and (3) is increased.

income under category (8) since 1980.[657] This finding is supported by the IMF paper, saying,

> "In 1989, Thailand carried out further tax reforms aimed at simplification, neutrality and revenue generation. ..... No attempt was made to reduce expense deductions and allowances for business incomes."[658]

This research proposes the abolition of standard deductions, for the purpose of equity, based on the justification above. Thai law should apply only a deduction of actual expenses for all categories of income, except for savings and dividends incomes.

In principle, a deduction for actual expenses is more likely to correspond to the ability-to-pay principle than a standard deduction. It means that taxpayers cannot deduct expenses exceeding those incurred in obtaining income. Additionally, it is logical. If taxpayers incur losses in their businesses in a tax year because deductible expenses exceed income, they should not pay tax. Tax laws must clearly set out what are and what are not regarded as actual expenses in respect of each category of income.

UK law sets out more specific rules than Thai law. The ITEPA 2003 and the ITTOIA 2005 have their own rules for determining deductible expenses. In general, there are no expenses to set against pension income and social security income under the ITEPA 2003, and against savings and investment income under ITTOIA 2005. However, there are expenses to set against employment income under the ITEPA 2003, against trading income, property income, and miscellaneous income under the ITTOIA 2005. Meanwhile, Thai law sets out general rules for the deduction of actual expenses from income under categories (5) (a) and (6)-(8), as we shall see later.

Expenses against employment income under the ITEPA 2003

Expenses are deductible if they are not reimbursed by the employer.[659] Where reimbursement is made, expenses can be deductible if the reimbursement is included

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[657] Such incomes are those deriving from (a) salt farming, (b) sale of ships, (c) sale of land by installment payments, and (d) the income of entertainers.
[658] Ke-young Chu et al., Income Distribution and Tax and Government Social Spending Policies in Developing Countries (Washington, D.C.: IMF, 2000), 34.
[659] Melville, op.cit.(note541), p.88

in the employee's earnings.[660] Additionally, expenses are subject to the general rule laid down in Section 336, the ITEPA 2003 that

(a) expenses are incurred and paid by the employee who is obliged to do so as holder of the employment, and that
(b) expenses are incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

'Wholly and exclusively' means that expenses must be incurred for the purpose of the employment and not for any personal purpose.[661]

The meaning of 'necessarily' is that "an expense will not be allowed unless it can be shown that the duties of the employment could not be performed (by anyone) if the expense were not incurred."[662]

The meaning of 'in the performance of the duties of the employment' is that "any expenses incurred before the employee's duties commence or after they terminate will not be allowed as a deduction."[663]

Furthermore, the ITEPA 2003 sets out some specific rules for particular employee expenses. According to specific rules, deductible expenses incurred by employees include, but are not limited to, fees and subscriptions to professional bodies[664], travel expenses for the performance of employment duties (which are neither ordinary commuting nor private travel).[665] The ITEPA 2003 also sets out specific rules on disallowed expenses. These include, but are not limited to, business entertainment and gifts expenses incurred by employees. However, these expenses are deductible, if they are (1) reimbursed by the employer, (2) included in the employee's earnings, (3) disallowed in computing the employer's profit from trade,[666] and (4) subject to the general rule in Section 336.

Expenses against property income under ITTOIA 2005

These are deducted, in general, according to "the capital prohibition rule" and "the wholly and exclusively rule." According to the capital prohibition rule,

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[660] Section 334, ITEPA 2003
[661] Whitehouse et al., op.cit.(note549), p.104
[662] Melville, op.cit.(note541), p.89
[663] CCH Tax Handbook , op.cit.(note12), p.1,307
[664] Sections 343, 344, ITEPA2003
[665] Sections 337, 338, ITEPA2003
[666] Sections 356, 357, ITEPA2003

deductible expenses do not include capital expenditure, i.e. in calculating the profits of a property business, "no deduction is allowed for items of a capital nature".[667]

According to the wholly and exclusively rule, a deduction for the expenditure is allowed when the expenditure is incurred wholly and exclusively for the purposes of property businesses.[668] For example, in calculating the amount of rent receivable in connection with letting a right to work minerals in the UK, "a sum wholly and exclusively [paid] as an expense of management or supervision of the minerals" is deductible.[669]

Expenses against income from trading income under ITTOIA 2005

Expenses must be revenue and not capital expenditure.[670] For example, interest is a deductible expense if "interest is an item of a revenue nature, whatever the nature of the loan."[671]

The difference between revenue and capital expenditures is as follows:

> "[The] cost of purchasing business premises is capital expenditure, while rent paid for business premises is revenue expenditure, and the cost of alterations, additions, improvements or renovations is capital, while the cost of repairs is revenue."[672]

Additionally, deduction is not allowed for "expenses not incurred wholly and exclusively for the purposes of the trade", profession or vocation.[673] And deduction is not allowed for "losses not connected with or arising out of the trade", profession or vocation.[674] If an expense is incurred for more than one purpose (e.g. partly for the purposes of the trade, profession or vocation and partly for personal purposes), "any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade", profession or vocation will be deductible.[675]

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[667] Section 33 and Section 272, ITTOIA 2005
[668] Section 34 and Section 272, ITTOIA 2005
[669] Section 339 (1) (a) (b), ITTOIA 2005
[670] Section 33, ITTOIA 2005
[671] Section 29, ITTOIA 2005
[672] CCH Tax Handbook, op.cit.(note12), p.1,319
[673] Section 34 (1) (a), ITTOIA 2005
[674] Section 34 (1) (b), ITTOIA 2005
[675] Section 34(2), ITTOIA 2005

Furthermore, the profits of the trade, profession or vocation must be calculated in accordance with generally accepted accounting practice.[676] The ITTOIA 2005 sets out special rules on disallowed expenses. The special rules include, but are not limited to, a debt owed to the person carry on the trade, profession or vocation[677], and crime-related payments.[678] The ITTOIA 2005 also sets out special rules allowable expenses. The special rules include, but are not limited to, bad debts[679], employee benefit contributions[680], gifts to employees[681], gifts to a charity[682], and pre-trading expenses.[683] (More details can be found in **Appendix IX to Chapter Three**).

Expenses against miscellaneous income under ITTOIA 2005

As regards expenses against royalties and other income from intellectual property other than annual payments, they must be incurred wholly and exclusively for the purposes of generating the income.[684] If an expense is incurred for more than one purpose, "any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of generating the income", will be deductible.[685] In addition, expenses which would not have been allowable as a deduction in calculating the profits of a trade, if they had been incurred for its purposes, are not deductible.[686]

As regards expenses against income from non-trade businesses involving the exploitation of films or sound recordings, the above rules also apply.[687]

As regards expenses against income from a relevant telecommunication right that is not used or held for the proposes of a trade, profession or vacation, the above rules also apply.[688]

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676 Section 25 (1), ITTOIA 2005
677 Section 35 (1), ITTOIA 2005
678 Section 55, ITTOIA 2005
679 Section 35 (1) (a), ITTOIA 2005
680 Section 38 (1) (b), ITTOIA 2005
681 Section 47 (4) (a) (b), ITTOIA 2005
682 Section 47 (5) (a), ITTOIA 2005
683 Section 57, ITTOIA 2005
684 Section 582 (2), ITTOIA 2005
685 Section 582 (3), ITTOIA 2005
686 Section 582 (4), ITTOIA 2005
687 Section 612 (2), (3), (4), ITTOIA 2005
688 Section 617 (2), (3), (4), ITTOIA 2005

As regards expenses against amounts treated as income of a settlor, the same deductions are allowed if the amount treated as the settlor's income had been received by the settlor as income.[689]

Actual expenses against business and self-employment incomes under Thai law

General rules are laid down as follows:

(a) taxpayers must produce evidence and prove that expenses under such evidences are necessary and reasonable, and

(b) rules on the deduction of expenses for computing the net profits of juristic companies and partnership shall apply *mutatis mutandis*.[690]

When we apply rule (a), deductible expenses must be incurred necessarily and reasonably for the purposes of letting property, profession or any other business. Additionally, when rule (b) is applied, capital expenditure is not deductible.[691] However, the following expenses may be deductible.

(1) certain reserves,

(2) contributions to a provident fund,

(3) expenses not connected with private purposes,

(4) donations to public charity or for public benefit,

(5) certain expenses on entertainment or services,

(6) wear and tear and depreciation of assets,

(7) costs of repair and maintenance of properties,

(8) the net losses brought forward from periods no longer than five years preceding the current tax year, and

(9) expenses incurred exclusively for the purpose of acquiring profits or doing any business.

From the above, the following conclusions and suggestions can be made to bring about equity.

Firstly, as there is no rule on actual expenses against employment income under Thai law, one should be introduced, similar to UK law. That is, employee

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[689]Section 623 (2), ITTOIA 2005

[690] Sections 5, 6, 7, 8, and 8 bis., Royal Decree No.11 (1959)

[691] Section 65 ter. (5), RCT

expenses are subject to the "wholly, exclusively and necessarily" rule (unless there are specific rules for particular employee expenses).

This research also proposes that employees' training costs and costs of updating professional skills or knowledge incurred during the period of employment should be deductible as employee expenses. This is because more educational and training opportunities will boost earning opportunities and reduce income difference. If employees' training costs and costs of updating professional skills or knowledge are deductible, this is likely to benefit employers also.

However, expenses for this purpose should also be incurred necessarily and reasonably. For example, if an employer installs the latest model of computers on which no employee can work, and some employees have to pay for a computing course so that they will be able to operate them.

Secondly, Thai law should set out specific rules on what are allowed or disallowed as actual expenses for each category of business and self-employment income (including any profits or gains, e.g. receipts from the sales of copyright, patent rights, trademark rights and know-how). This is because the application of specific rules would (i) identify the actual expenses in respect of each category of income, and (ii) avoid the problem of interpreting general rules. The following expenses should be the core of specific rules:

(1) expenses incurred wholly, exclusively, necessarily and reasonably in letting property, exercising a profession, doing any business, or making any profits or gains,
(2) revenue and not capital expenses,
(3) expenses not connected with private or domestic purposes, and
(4) staff training and business owners' costs of updating professional skills or knowledge.[692]

Thirdly, the laws of both countries should keep the rules on actual expenses updated because of the emergence of new businesses and professions.

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[692] The reason for (4) is similar to that for expenses against employment income. If expenses under (4) are deductible, they are likely to help create earning opportunities for employees and proprietors. In other words, well-trained employees will possibly be promoted and earn more income. Meanwhile,

2.2.3 Tax expenditures (non-structural reliefs)

Exempt income and itemized deductions are regarded as tax expenditures because neither is an essential part of the tax structure and both have been introduced to discharge or reduce the tax burden on particular types of individual.

As regards exempt income under Thai law, many provisions have been laid down to serve various purposes, which include exemptions relating to:

(a) the avoidance of double taxation,
(b) inheritance,
(c) capital gains,
(d) savings in bank accounts or savings products,
(e) expenses for the purpose of employment or service rendered,
(f) welfare money and benefits in kind of civil servants and employees of state enterprises,
(g) benefits in kind of employees of private enterprises,
(h) income and benefits in cash for state service,
(i) medical expenses and casualty losses,
(j) education and research,
(k) prizes,
(l) the promotion of certain business activities,
(m) compensation,
(n) compensatory benefits,
(o) moral obligation, ceremonies and traditions,
(p) transfers of immovable property without payment,
(q) stimulation of economic recovery of the country from recession by persuading people to invest in immovable property,
(r) particular groups of foreigners working in Thailand,
(s) savings in pension or retirement funds, and
(t) savings through the life-insurance policies.

(More details on (a)-(t) can be found in **Appendix X to Chapter Three**).

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proprietors or professional people who update their professional skills or knowledge are likely to secure their businesses or professions and to earn more income.

Meanwhile, the income-tax base under UK law is narrowed by "too many exceptions."[693] Exemptions include those relating to:

(a) social security benefits,

(b) savings in bank accounts, savings products, and savings through the purchase of shares or securities,

(c) savings through personal pension schemes,

(d) savings through life insurance and life annuity,

(e) compensation,

(f) education, research and training

(g) prizes and winnings,

(h) benefits in cash and in kind relating to employment,

(i) income and benefits in cash for state service,

(j) welfare money to civil servants and politicians,

(k) moral obligation, ceremonies and traditions,

(l) casualty losses,

(m)non-UK resident taxpayers,

(n) an annual payment, and

(o) other purposes.

(More details on (a)-(o) can be found in **Appendix X to Chapter Three**).

As regards itemized deductions, Thai law allows a taxpayer to deduct certain payments (or "tax allowances") from his/her chargeable income, after the subtraction of deductible expenses and personal allowances, to obtain net/taxable income. Such payments/allowances are:

(a) 2,000 baht for the education of each child,

(b) life insurance premiums for the actual amount but not exceeding 10,000 baht,

(c) an employee's contribution to the Provident Fund for the actual amount but not exceeding 10,000 baht,

(d) mortgage interest payment for the actual amount but not exceeding 10,000 baht,

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[693] Geoffrey Howe, Simplicity and Stability: The Politics of Tax Policy (London: Centre for Policy Studies, 2001), 31.

(e) social security contributions for the actual amount (no ceiling), and

(f) monetary charitable contributions for the actual amount but not exceeding 10% of chargeable income after the subtraction of deductible expenses, personal allowances and allowances as mentioned in (a)-(e) above.[694]

Under UK law, certain types of payment which are known as charges on income can be deducted from the taxpayer's chargeable income after the subtraction of allowable expenses in arriving at total income.[695] Charges on income which are eligible for tax-deduction include:

(a) patent and copyright royalties[696];

(b) eligible interest payments[697], i.e. the interest paid gross on loans for the following purposes:

 (i) to buy machinery or plant[698],

 (ii) to buy an interest in a closed company[699],

 (iii) to buy an interest in a co-operative or employee-controlled company[700],

 (iv) to buy into partnership[701],

 (v) to pay inheritance tax[702], and

 (vi) to buy life annuity[703];

(c) "gifts of listed shares or securities to a charity"[704];

(d) "gifts of land or buildings to a charity"[705], and

(e) "certain annual payments made for *bona fide* commercial reasons."[706]

Additionally, contributions to approved pension funds (i.e. occupational pension, personal pension, and stakeholder pension funds) are tax-deductible.[707] For

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694 Section 47, RCT

695 Section 835, TA1988
Chris Whitehouse and Peter Vaines, Revenue Law: Principles and Practice, 20th ed. (London: Reed Elsevier (UK) Ltd., 2002), 43.

696 Melville, op.cit.(note541), p.42

697 ibid.p.42

698 Section 359, TA1988

699 Section 360, TA1988

700 Section 361, TA1988

701 Section 362, TA1988

702 Section 364, TA1988

703 Section 365, TA1988

704 Melville, op.cit.(note541), p.42

705 ibid.p.42

706 Whitehouse and Vaines, op.cit.(note695), p.48

example, a contribution of up to 15% of earnings to an occupational pension fund is deductible from employment income.[708] Premiums of up to £3,600 per year paid to a personal pension fund are also deductible irrespective of age and earnings.[709]

Tax exemptions and itemized deductions tend to have a negative rather than a positive effect on equity. This is because they undermine horizontal and vertical equity and lower the effective tax rates of higher-income groups below statutory rates.

Exempt income and itemized deductions are only available to particular types of individual. Consequently, taxable income of some individuals are narrowed and reduced, whereas those of others are unchanged. Comparing two persons with equal income but from different sources, one whose income is excluded from taxable income pays no tax, while another whose income is included in the income-tax base is taxed. Altogether, exempt income and itemized deductions bring about horizontal inequity.

Exempt income and itemized deductions also undermine vertical equity.

Firstly, the poorest whose income falls below the tax threshold gain no benefit from tax expenditures.[710] This is because "to benefit from a tax relief, it is necessary to have a tax liability to be reduced."[711]

Secondly, although the tax liability of poorer taxpayers is discharged or reduced, that of richer taxpayers is also discharged or reduced as a result of tax expenditures. Consequently,

(a) the rich are discharged from a greater tax liability than the poor;

(b) the rich may pay the same amount of income in tax as the poor; and

(c) the rich may pay less income in tax than the poor.[712]

Finally, exemptions and deductions generate the possibility of discharging or reducing the tax liability of higher-income groups for two reasons.

(i) Tax expenditures may be intentionally or unintentionally designed to benefit these groups, i.e. significant sources of the income of the wealthy are non-

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707 Lymer et al., op.cit.(note120), pp. 3/15, 5/23, 5/24, and 5/26.

708 Melville, op.cit.(note541), p.204

709 ibid.p.214

710 James, op.cit.(note2), p.146

711 Willis and Hardwick, op.cit.(note560), p.12

712 Examples for (a) – (c) can be found in **Appendix XI to Chapter Three.**

taxable[713]; and the wealthy are more likely to incur expenses which are allowable against chargeable income.[714]

Capital/financial income[715] is a substantial source of the income of the wealthy.[716] However, many types of capital gains (in Thailand) and the return on savings/financial products (both in Thailand and the UK) are non-taxable. For example, Richupan notes, "tax exemption of interest from government bonds induces a higher degree of inequity since this is equivalent to paying higher rates of interest to high income investors."[717] Meanwhile, wealthier, older households in the UK tend to hold TESSAs and PEPs.[718] The benefits from PEPs, TESSAs, and ISAs "inevitably, have largely accrued to the relatively well-off, who save much more than those on low incomes.[719]

(ii) Tax expenditures are legal loopholes for high-income people to avoid tax.[720] This is because high-income groups have considerable resources to shift to tax-free or tax-preferred activities. For example, "in 1995 the £9.3 billion of tax relief for occupational contributions was distributed as follows: 2.3 per cent to the poorest quintile of taxpayers; .... and 67.2 per cent to the top quintile."[721] Additionally, high-income groups can afford a tax expert's fee to take advice on tax-free or tax-preferred activities.

Thus, this research agrees with Harrington (referred to in Steinmo) when he says, "a tax system [via tax expenditures] is a welfare system for the rich."[722]

Tax expenditures can also make PIT less vertically equitable by undercutting the degree of tax progressivity. This is because although the poor pay a smaller proportion of their income in tax as a result of tax expenditures, the rich pay a much smaller proportion. This results from the fact that tax expenditure make effective tax rates less than statutory tax rates.

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[713] The World Bank, op.cit.(note112), p.27
[714] Stotsky, op.cit.(note509), p.123
[715] i.e. interest, dividends, capital gains
[716] Richupan, op.cit.(note512), p.16; Stotsky, op.cit.(note509), p.122; and Stiglitz, op.cit.(note68), pp.512-513
[717] Richupan, op.cit.(note512), p.79
[718] William Gale, "What Can America Learn from the British Tax System?", Fiscal Studies (1997) Vol. 18, No.4, 356.
[719] The Commission on Taxation and Citizenship, op.cit.(note22), p.244
[720] Hyman, op.cit.(note35), p.500
[721] Maurice Saatchi, The Science of Politics (London: Weidenfeld & Nicolson, 2001), 81.

Since tax exemptions reduce effective tax rates (both ATR and MTR) to zero on income from certain activities, the rich who derive such income receive a greater proportionate reduction in their tax burden than the poor. (Example 3.8 in **Appendix XII to Chapter Three** helps clarify these points.)

Itemized deductions also reduce effective ATRs. As certain payments are allowable against chargeable income, they reduce taxable income and effective ATRs. However, higher-income taxpayers are more likely to benefit from these advantages than lower-income taxpayers for two reasons.

(i) Itemized deductions are given at the actual amount of payment (up to a maximum limit) to certain taxpayers. The rich tend to make larger payments than the poor, giving them a greater reduction in taxable income.

(ii) A reduction in taxable income subject to the high MTR makes a greater reduction in the effective ATR than a reduction in taxable income subject to the low MTR. Consequently, high-income taxpayers receive a greater reduction in the effective ATR than low-income taxpayers.

Therefore, a reduction in the effective ATR relies on (a) the number of itemized deductions claimed and (b) statutory MTRs applied. (Example 3.9 in **Appendix XII to Chapter Three** helps clarify these points.)

Altogether, exempt income and itemized deduction affect equity. We should therefore de-emphasize tax expenditures. Similarly, if we want the structure of PIT to have the effect of promoting a more equal distribution of income, tax expenditures should be reformed.[723] Nevertheless, we cannot abolish all of tax expenditures for two reasons.

(i) They have a positive effect on equity to some extent when we look at the lower end of the income scale, i.e. low-income earners can pay less and a smaller proportion of their income in tax.

(ii) Certain tax expenditures can achieve other social objectives and a more equitable tax system. As Willis and Hardwick claim, "it would be quite wrong to conclude that tax expenditures are necessarily bad."[724]

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[722] Steinmo, op.cit.(note581), p.157
[723] Chandr-ruang-phen and Sayakanit, op.cit.(note632), p.124
[724] Willis and Hardwick, op.cit.(note560), p.15

This research proposes that the following tax expenditures should be removed to promote equity:

(a) those which benefit the rich more than the poor,

(b) those which add to the taxpayer' s net worth,

(c) those which can be replaced by direct subsidy/grant,

(d) those which lead to tax avoidance and tax arbitrage , and

(e) those which are not equivalent to the costs of earning income.

(a) Tax expenditures beneficial to the rich

A tax allowance for life insurance premiums and tax exemption for income paid as life insurance premiums (under Thai law) should be removed because high-income groups are more likely to purchase life-insurance policies. In the UK "no tax relief is available for the premiums on life assurance policies that come into force on or after 14 March 1984."[725]

Additionally, the wealthy in Thailand trade in, invest in and/or accumulate valuable movable property, immovable property and securities. However, many capital gains and income paid for buying immovable property or paid as interest on loans to buy or invest in immovable property are non-taxable income. Moreover, mortgage interest payment is tax-deductible. These tax expenditures benefit rich rather than poor people; therefore, they should be removed from Thai law. In the UK, a mortgage interest relief was abolished from 6 April 2000.[726]

The poor are unlikely to receive benefit from a mortgage interest relief. As Whittington notes, "home ownership is closed to those on low incomes who cannot offer security for a mortgage."[727] Moreover, low-income earners in Thailand may be refused housing loans because their earnings do not satisfy the criteria of lenders. Rosen points out that the rich are more likely to benefit from a mortgage interest relief because they tend to have "good access to borrowing."[728] Saatchi notes that "tax breaks that accrue disproportionately to the higher income groups" include a mortgage interest relief.[729] Since this relief is more likely to benefit the rich, Sanford suggests (1977) that "ceasing to allow the mortgage interest on owner-occupied

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[725] Foreman and Mowles, op.cit.(note574), p.218
[726] ibid. p.207
[727] Whittington, op.cit.(note53), p.164
[728] Rosen, op.cit.(note250), p.353

houses as a tax allowance" could increase "the proportion of tax paid by those with the highest incomes and the most expensive houses."[730]

The wealthy in both Thailand and the UK are also more likely to save money in savings accounts/products. However, interest on certain forms of savings accounts/products is non-taxable. Given this, I agree with Kaldor who notes, "the exemption of savings would lead to greatly enhanced savings by the richer classes, and thus to an even more unequal distribution of wealth in the long run."[731] Therefore, these tax exemptions (under both laws) should be removed

(b) Tax expenditures as an increase in net worth

Tax expenditures that can add to individuals' net worth should be abolished. The World Bank notes, "if [tax expenditures] are not carefully designed, they can confer windfall gains on existing and inframarginal activities."[732]

The exemption of prizes and winnings (under both laws) and certain capital gains (under Thai law) should be abolished because they are windfall gains for particular individuals.

The exemption of inheritance and proceeds from the sale of movable and certain kinds of immovable property acquired by inheritance (under Thai law) should be abolished because they are windfall income to inheritors.[733] The exemption of the transfer of immovable property to the taxpayer's lawful child without any consideration (under Thai law) should also be abolished because it increases net worth to a child (including an adult child).

The exemption of income paid to buy immovable property or paid as interest on loans to buy or invest in immovable property (under Thai law) should also be abolished. This is because this exemption increases the buyer's ability to pay.

The exemption of income from certain business activities, not including income from the sale of rice cultivated by the farmer (under Thai law), should be abolished because the spending power of the business owners increases.

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729 Saatchi, op.cit.(note721), p.81
730 Sandford, op.cit.(note19), pp.154-155
731 Kaldor, op.cit.(note54), p.88
732 The World Bank, op.cit.(note112), p.60
733 Additionally, tax exemption of inheritance should be abolished because Thailand has no inheritance tax.

The exemption of interest and any form of return on saving accounts/products and on securities (under both laws) should be abolished because they increase savers' and investors' economic power.

The exemption of certain fringe benefits (which are neither related to an employee' s, a civil servant's or a politician's carrying out his/her duty nor to expenses incurred in relation to his/her employment or service rendered) should be abolished. Such benefits are part of certain individuals' payment, and exemptions add to their net worth. In addition, fringe benefits are likely to benefit highly paid employees, undermining tax progressivity.[734] Such benefits include:

(i) welfare money and benefits in kind to civil servants and employees of state enterprises (under Thai law),

(ii) welfare money of civil servants and politicians (under UK law),

(iii) benefits in kind to employees of private enterprises (under Thai law),

(iv) benefits in cash and in kind (under UK law) which are related to employment, and

(v) income and benefits in cash for state service (under Thai law).

Contributions to personal pension funds (under both laws) are tax-deductible. The contributions are made for employees to receive benefits (or lump sums) from the funds in the future. Under both laws, lump sums received from pension funds are tax exempt.

As we shall see later, these lump sums can be justified as non-taxable because they are paid out when individuals have less taxable capacity (i.e. in older ages). So, such benefits can compensate for a reduction in individuals' ability to pay. Meanwhile, the tax deduction of contributions to pension funds is likely to add to an individual's net worth and should be abolished. This is because deductibility reduces taxable income and income tax while an individual is still in working life.[735]

Under Thai law, an employee's contribution to the Social Security Fund (from which compensatory benefits are paid) is allowable against chargeable income. (This differs from an employee's National Insurance contribution (under UK law) which is not deductible). Social security contributions are made so that employees

[734] Stotsky, op.cit.(note509), p.122

receive compensatory benefits in the future. And under Thai law, compensatory benefits are tax exempt.

According to Stotsky,

"To the extent that social security taxes were not deducted from taxable income when they were contributed, the benefits are properly excluded from income when paid out. Many income tax systems, however, allow taxpayers to exclude social security taxes from taxable income. In this case, the benefits are properly included in income when paid out."[736]

The Thai tax treatment of social security contributions and compensatory benefits differs from that quoted above. As we shall see later, compensatory benefits can be justified as non-taxable because they are paid out when individuals are needy or have less taxable capacity (e.g. the sick, the unemployed, or etc.). Conversely, tax relief on social security contributions adds to an individual's net worth and should be abolished. This is because it reduces taxable income and income tax while an individual is in good health and employed.

(c) Tax expenditures being replaced by direct subsidy

Those under (c) should be withdrawn, as assistance to certain groups of people or activities can be made more efficiently and equitably through direct subsidies/grants than through tax expenditures.[737] Direct subsidies/grants can work more efficiently and equitably in certain circumstances, e.g. assistance for home-ownership and education, because direct subsidies/grants can help the poorest whereas tax expenditures cannot. As Willis and Hardwick note, "in order to benefit from a tax relief, it is necessary to have a tax liability to be reduced whereas a direct grant may be available irrespective of income."[738] Additionally, high-income earners can be prevented from taking direct subsidies/grants.

One possible reason to encourage home-ownership is that it can "make people more stable and secure, reduce juvenile delinquency and so on."[739] A

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[735] Another reason for abolishing relief for personal pension contributions is that this relief accrues disproportionately to higher income groups. (Saatchi, op.cit.(note721), p.81)

[736] Stotsky, op.cit.(note509), p.122

[737] Sven Steinmo, "Taxes and Taxation", The Oxford Companion to Politics of The World, 2nd ed., Joel Krieger ed. (Oxford: Oxford University Press, 2001), 829.

[738] Willis and Hardwick, op.cit.(note560), p.12

[739] Eckstein, op.cit.(note49), p.66

mortgage interest relief can encourage people to buy their homes. However, this relief benefits the rich more than the poor, while direct subsidies could be designed to provide financial assistance or low-cost housing for lower-income groups. As Willis and Hardwick note, "it might give the same subsidy to all or it might treat the poorer owner-occupiers preferentially but it would hardly give an explicit preference to the richer ones."[740] Therefore, a mortgage interest relief and tax exemption of income paid for immovable property or paid as interest on loans to invest in immovable property should be removed from Thai law.

(d) Tax expenditures leading to tax avoidance

Those under (d) should be abolished. Thirsk points out that "reluctance to tax interest income when combined with the deductibility of interest expense opens up significant opportunities for both tax arbitrage and tax evasion."[741] Likewise, "interest deductibility in conjunction with preferential treatment of certain capital income can create major money-making opportunities."[742] These arguments match the fact that the wealthy have more chance to access loans and to incur interest expenses, and may manipulate their resources (under contrived schemes) for tax-preferred activities and tax arbitrage.

James gives an example of tax arbitrage as follows:

> "[In] some circumstances it may be profitable to borrow money, deduct the interest payable from taxable income, and invest the money elsewhere."[743]

For the above reasons, governments should consider abolishing (a) the exemption of capital gains (under Thai law), (b) the exemption of any form of return on financial products or savings (under both laws), (c) the deduction of mortgage interest payment (under Thai law), (d) the deduction of life insurance premiums, and (e) the exemption of income paid as life insurance premiums (under Thai law).

(e) Tax expenditures not equivalent to revenue costs

Those under (e) should be abolished. That is, reliefs for interest on loans for personal purposes, e.g. housing loans (under Thai law), loans to pay inheritance tax and loans to buy life annuity (under UK law).

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740 Willis and Hardwick, op.cit.(note560), p.12
741 Thirsk, op.cit.(note64), p.40
742 Rosen, op.cit.(note250), p.353
743 James, op.cit.(note2), p.142

Conversely, the following exempt income and itemized deductions should be maintained or further introduced:

(a) those which are equivalent to the costs of earning income,

(b) those which are designed to benefit those with less taxable capacity,

(c) those which compensate for a reduction in a taxpayer's ability to pay,

(d) those which promote socially important activities,

(e) those which are justified on social and moral grounds, and

(f) those which prevent double taxation.

(a) Tax expenditures as revenue costs

Income tax is paid after the deduction of costs incurred in generating income. Therefore, governments should maintain the following:

(i) tax exemption for expenses incurred in relation to employment and service rendered (under Thai law),

(ii) tax exemption for fringe benefits (under UK law) which an employee receives for carrying out his/her duty of employment, or for expenses incurred in relation to employment and service rendered, and

(iii) relief for charges on income (under UK law), which are patent and copyright royalties, annual payments made for commercial reasons, and interest paid on loans for business purposes (e.g. to buy machinery), but not for personal purposes (e.g. to pay inheritance tax).

As regards interest expenses, only interest paid on loans for business purposes is tax-deductible because it is a cost of doing business which generates income subject to tax.[744] It appears that "most countries allow a deduction for interest expense only if the interest is traceable to borrowing for business or investment."[745] Conversely, interest on loans for personal purposes is not a cost of generating income subject to tax. Therefore, the Thai government should consider the removal of mortgage interest relief and the exemption of income paid as personal interest on loans to buy or invest in immovable property. Interest on a housing loan would be deductible if "the imputed income from homeownership were taxed."[746] Meanwhile,

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[744] Rosen, op.cit.(note250), p.352; and Hyman, op.cit.(note35), p.499

[745] Thuronyi, op.cit.(note10), p.245

[746] Stotsky, op.cit.(note509), p.123

the UK government should consider the removal of tax relief on personal interest on loans to pay inheritance tax.

(b) Tax expenditures beneficial to people with less taxable capacity

The World Bank claims that "if exclusions are appropriately targeted, the tax burden on the poor can be minimized."[747] Thus, tax expenditures that can reduce the tax burden on those with less taxable capacity should be maintained. In Thailand, farmers have the lowest taxable capacity as the poorest group. The exemption of income from the sale of rice cultivated by the farmer should then be maintained.

Older people have less taxable capacity than younger people. The pension is the main source of income of this group. This should therefore be excluded from taxable income. Under Thai and UK laws, lump sums derived from personal pension funds are non-taxable. However, it is argued that if part of the lump sums received from any pension fund has been contributed by employers, such benefits and interest thereof should count as taxable income. This is because employers' contributions are fringe benefits which add to "the employees' net worth."[748]

In my view, investments (or contributions) of employees paid out of pension money/income are eligible for tax exemption because they now provide income to the elderly who have less taxable capacity. Additionally, (a) any benefit or interest arising from such investments, and (b) employers' contributions to pension funds (if any), including any benefit or interest thereof, should be eligible for tax exemption because:

- benefits under (a) and (b) are not received when the individuals are young; therefore, they do not appear to add to their net worth; and
- benefits under (a) and (b) are received when individuals are old, which reduces their ability to pay; consequently, they are likely to offset such reduction rather than add to individuals' economic power.

This can weaken the argument that employers' contributions to pension funds are part of employees' wages. (More discussion will be made below). Therefore, this research supports tax exemption of lump sums derived from pension funds in both laws. Nevertheless, to prevent richer pensioners (e.g. highly paid employees who

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747 The World Bank, op.cit.(note112), p.26
748 Hyman, op.cit.(note35), p.492

may have made large investments and benefited from substantial employers' contributions during their working lives) from receiving greater benefit from tax exemption than poorer pensioners, a ceiling of tax exemption should be required. For example, lump sums not exceeding 600,000 baht or £10,000 would be non-taxable.

Employees whose income is disrupted by other causes also have less taxable capacity, as pointed out by Chandravithun and Vause:

> "Many employees find it difficult to support themselves and their families when income is disrupted by illness, injury, pregnancy, disability, old age or unemployment."[749]

In Thailand, such employees are entitled to compensatory benefits paid from the Social Security Fund. This fund is compulsorily and equally contributed to by three parties, i.e. the government, the employer and the insured employee under the Social Security Act. There are seven types of compensatory benefit paid from this fund, namely injury or sickness benefit, maternity benefit, physical disability benefit, death benefit, child welfare, old-age pension benefits, and unemployment compensation.[750] Compensatory benefits are non-taxable in Thailand.

UK social security benefits, however, are given to other people than employees. The benefits are financed by general taxation and the National Insurance Fund.[751] They are classified in three groups:

(a) "means-tested, available to people whose income and savings are below certain levels",

(b) "contributory, paid to people who have made the required contributions to the National Insurance Fund", and

(c) "benefits which are neither means-tested nor contributory (mainly paid to cover extra costs, for example of disability, or paid universally, for example Child Benefit)."[752]

UK tax treatment of social security benefits is also different from that of Thailand. Compensatory benefits under Thai law are all non-taxable, while not all

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749 Nikom Chandravithun and W. Gary Vause, Thailand's Labor and Employment Law: A Practical Guide (Bangkok: Manager Publishing, 1993), 47.

750 Section 54, Social Security Act (B.E. 2533)

751 ONS, UK 2003: The Office Yearbook of the United Kingdom of Great Britain and Northern Ireland (London: TSO, 2002), 140.

752 ibid.pp.140-141

UK social security benefits are. According to a survey in 2003, "most means-tested social security benefits are not liable to income tax."[753] And "many non-means-tested benefits are taxable (e.g. the basic state pension), but some (notably child benefit) are not."[754]

In my view, social security benefits can be justified as tax-free income if beneficiaries are those having less taxable capacity, e.g. the unemployed, the elderly, the injured, the sick, the disabled, the poor, and those with dependent children. This is because if the benefits were taxed, such beneficiaries would pay tax or pay more in tax, which would thwart income redistribution. There is evidence that social security or cash benefits play "the largest part in reducing [income] inequality" in the UK.[755] And "the majority of cash benefits for non-retired households come from non-contributory benefits and, for retired households, from contributory benefits, particularly the state pension."[756]

Given this, means-tested benefits are justified as tax-free income. For example, housing benefit is designed to help "people who rent their homes and have difficulty meeting their housing costs"[757], and council tax benefit designed to help "people on low incomes pay their council tax."[758] Benefits which are neither means-tested nor contributory are also justified as tax-free income, for example, child benefit designed to help "families with two or more children"[759], and disability living allowance designed to help "people who became disabled before the age of 65."[760]

Meanwhile, from my standpoint, certain means-tested or income-related benefits (e.g. income support) and contributory benefits (e.g. incapacity benefit, jobseeker's allowance) which are taxable at present[761] and can also be treated as non-taxable under condition[762] should be non-taxable without condition. This is because

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753 Stuart Adam and Jonathan Shaw, A Survey of the UK Tax System: IFS Briefing Note No. 9, (http://www.ifs.org.uk/taxsystem/taxsurvey.pdf), 4.
754 ibid.p.4
755 Caroline Lakin, "The effects of taxes and benefits on household income, 2001-02", Economic Trends, No. 594, May 2003, 34.
756 ibid. p.34
757 Department for Work and Pensions, Work and Pension Statistics 2002 (Newcastle: Department for Work and Pensions, 2002), 149.
758 ibid.p.156
759 ibid.p.105
760 ibid.p.163
761 See page 137
762 See **Appendix X to Chapter Three** at pages 457 and 458

they are designed to help those with less taxable capacity. For example, income support designed to help "pensioners, lone parents, carers and sick/disabled people"[763], incapacity benefit designed to help "people who are assessed as being incapable of work (at present taxable after 28 weeks of incapacity)"[764], jobseeker's allowance designed to help "people under state pension age who are available for, and actively seeking, work of at least 40 hours a week."[765]

One possible reason why many contributory benefits are taxable under UK law is that these benefits are paid from the National Insurance Fund. This fund is financed by National Insurance contributions comprising employers' and employees' contributions.[766] Since employers' contributions are argued to be part of employees' wages, contributory benefits are taxable. Sandford also argues that employers' contributions to national insurance constitute "a part of the employee's wage and therefore should count as income of the employee."[767]

As discussed earlier, compensatory benefits in Thailand are all non-taxable although they are paid from the Social Security Fund which is financed by the government, employers and employees. Compensatory benefits differ from contributory benefits. Therefore, what should be the proper tax treatment of compensatory benefits and contributory benefits, whether taxable or non-taxable.

Both types of benefit merit being non-taxable for the following reasons.

Compensatory benefits are financed by three parties and contributory benefits by two parties. Benefits partly financed by the government (compensatory benefits) are reasonably non-taxable because they are transfer payments (or government spending) to help those in financial need, and thus promote income redistribution. Additionally, benefits partly financed by employees (in both cases) are reasonably non-taxable because they provide income for those having less taxable capacity (as reasoned earlier).

The question then arises whether or not benefits partly financed by employers (in both cases) are reasonably non-taxable. This question is raised because employers' contributions are claimed to be part of employees' wages that should be

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[763] Department for Work and Pensions, op.cit.(note757), p.141
[764] ibid.p.123
[765] ibid.p.116
[766] ONS, op.cit.(note751), p.141; and Lakin, op.cit.(note755), p.44

included into taxable income. In my opinion, benefits financed by employers should be non-taxable if they can be justified as compensation for a reduction in an individual's ability to pay or on social and moral grounds (other than helping those in financial need).

In general, both compensatory and contributory benefits are likely to be justified as compensation for a reduction in individuals' ability to pay or on social and moral grounds. Old age, injury, sickness, maternity, disability, incapacity, unemployment and death reduce ability to pay. Compensatory benefits (such as old-age pension benefits, injury or illness benefits, maternity benefits, physical disability benefits, unemployment compensation, and death benefit) and contributory benefits (such as retirement or state pensions, incapacity benefit, and jobseeker's allowance) can compensate. Stotsky notes, "death benefits and disability or sickness benefits are also typically excluded from income on the grounds that they represent compensation for a loss rather than an increase in an ability to consume."[768] Additionally, death benefit and child welfare as compensatory benefits can be justified on social and moral grounds.

Furthermore, the argument that employers' contributions are part of employees' wages can be refuted. The refutation is that despite appearing to be part of employees' wages, employers' contributions do not add to employees' economic power but are likely to offset a reduction in employees' ability to pay or in their economic power.[769] Income subject to tax is accretion to a person's economic power. Income that is not accretion but which offsets a decrease in economic power should not be taxed. Therefore, employers' contributions should not be regarded as taxable income.

Altogether, compensatory benefits are reasonably non-taxable. This research supports tax exemption of these benefits under Thai law. Similarly, contributory benefits (under UK law) which are taxable at present should be non-taxable without condition if they meet the above criteria (e.g. state pensions, incapacity benefit, and jobseeker's allowance). Nevertheless, in the case of old-age or state pensions, a

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[767] Sandford, op.cit.(note19), pp.127-128
[768] Stotsky, op.cit.(note509), p.122
[769] Similarly, employers' contributions are regarded as another tax on employers without effects on employees' economic power.

ceiling for tax exemption of benefits partly financed by employers may be required to prevent richer pensioners from receiving greater benefits from tax exemption than poorer pensioners.

(c) Tax expenditures as compensation for taxable capacity

Sickness, injury, and casualty (e.g. losses from accident, fire, etc.) reduce a person's well-being. As Stotsky notes, "[casualty and theft losses] impair ability to pay."[770] In addition to social security benefits, medical expenses, damages and indemnities are money paid for the recovery of a loss in a person's welfare. Similarly, Rosen writes, "medical expenses do not really contribute to an individual's ability to pay."[771] Therefore, they should not be counted as taxable income.

This research therefore supports the view that tax exemptions for medical expenses paid by employers (under Thai law), the provision for an employee of medical treatment outside the UK (under UK law), and damages and indemnities for casualty losses (under both laws) should be maintained.

(d) Tax expenditures as encouragement of beneficial activities

Those under (d) (such as foundation or charity donations, education, research and training) should be maintained. In general, the function of foundations and charities is to help the poor or needy. The more donations the better off make to these, the more income will be redistributed. Therefore, such non-governmental organizations can help governments to implement the policy of income redistribution. Governments should therefore encourage foundational and charitable donations through tax exemption and relief. Many support this argument. Hyman writes, "the tax deduction for charitable contributions seems to be a very effective means of encouraging donations."[772] Likewise, deduction for charitable giving encourages "a higher level of these activities and they are socially beneficial activities."[773]

Tax exemption for the transfer of immovable property to foundations (or temples) without any payment (under Thai law) should therefore be maintained. Tax relief for charitable donations under both laws should also be maintained. However,

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770 Stotsky, op.cit.(note509), p.123
771 Rosen, op.cit.(note250), p.350
772 Hyman, op.cit.(note35), p.500
773 Stotsky, op.cit.(note509), p.123

the wealthy are likely to receive most tax relief because they can best make such donations. Most governments seem to recognize this. Hence, the deductibility of charitable contributions is "subject to strict definitions and limitations."[774]

According to Thai law, only monetary charitable donations are deductible. And they are deductible for an actual amount subject to a maximum limit. Furthermore, donations must be made to specified charities, i.e. government-owned clinics and educational institutions, and public charity organizations or institutions, or clinics and educational institutions. According to UK law, charitable donations eligible for tax relief can be made in the form of (a) gifts of listed shares or securities, (b) gifts of land or buildings, and (c) money.

In my view, charitable donations eligible for tax relief should not be limited only to monetary donations. Donations of assets that can be realized should also be deductible at market value (as in the UK). However, donations should be made only to specified charities, the main objective of which is to help people in need. (Therefore, I disagree that Gift Aid relief should be available for donations made to community amateur sports clubs as well as charitable donations).[775] Additionally, the deductibility of charitable donations should not be subject to a ceiling. Without a ceiling, the PIT might encourage the wealthy to increase charitable giving in order to qualify for more tax relief. (Deductibility without a ceiling is unlikely on its own to persuade the wealthy to increase charitable giving by very much, which would lead to tax avoidance and tax arbitrage).[776] In return, the poor would receive more financial assistance from charities. This is likely to be another way to achieve vertical redistribution.

Education and research are also socially important activities. Differences in educational and training opportunities cause unequal distribution of income. More such opportunities will boost earning opportunities and thus reduce differences in income. Therefore, governments should encourage education, training and research through tax exemption and relief in addition to direct subsidies. Therefore, governments should maintain tax exemptions for income received for education and

[774] Throop Smith, op.cit.(note401), pp.915-916
[775] Melville, op.cit.(note541), p.51

research (under both laws). An educational allowance for dependent children (under Thai tax law) should also be maintained.

In my view, a subsidy for education should go to the poorest, whose income is below the tax threshold. Meanwhile, an educational allowance under the tax system should be maintained because (a) education is important (as reasoned above), (b) this allowance will encourage low-income families to send their children to school, and (c) the tax burden on these groups will be reduced at the same time. However, this allowance should be cancelled for high-income taxpayers because these groups can afford the costs of education for their children.

Finally, training is a beneficial activity. It helps create earning opportunities for employees and those becoming employed. Similarly, well-trained employees and people will probably be employed and promoted, and earn more income. This research therefore supports the view that tax exemptions for the provision for an employee of work-related training, the payment of training grant, and the payment of retraining course expenses (under UK law) should be maintained.

(e) Tax exemptions justified on social and moral reasons

Governments should maintain tax exemptions under (e) which include:

(i) maintenance income derived from moral obligation (under Thai law),

(ii) gifts relating to ceremonies or traditions (under both laws),

(iii) pensions and gratuities paid for state or armed force services, e.g. war widow's pensions (under UK law), and special pension, special gratuity, inherited pension or inherited gratuity (under Thai law),

(iv) maintenance payments following divorce or separation (under UK law), and

(v) compensation (under both laws).

(f) Tax exemptions as prevention of double taxation

Tax exemptions that can prevent double taxation should be maintained and promoted.

[776] Although charitable donations provide tax relief for the taxpayer (the donor), they do not benefit the donor. (Charitable donations benefit the donee rather than the donor). Thus, the deductibility of

3. Concepts and effects of an income-tax base on efficiency

3.1 Revenue loss

As we have seen, the income-tax base is eroded by tax reliefs, leading to revenue loss. This is because structural reliefs reduce the taxable income of most individuals; meanwhile, tax expenditures discharge or reduce tax burdens on particular types of individuals. Additionally, the wealthy can shift resources to tax-preferred activities.[777]

From the UK experience, tax reliefs have reduced tax revenue. In 1973/4, Willis and Hardwick (referred to in Pond) estimated revenue loss as follows:

> "[Only] 45% of total (aggregate) gross income was subject to tax. Structural allowances and deductions accounted for 32% of total gross income, while non-structural deductions accounted for 15%."[778]

In 1997-98, Saatchi discovered that "the unrelieved taxable potential of the present tax structure levied by the Exchequer on companies and individuals amounted to £434.9 billion [;] [but] £134.9 billion almost a third of the total, was given back in the form of reliefs and allowances."[779] The estimated costs of principal tax expenditures and structural reliefs for income tax for 2003-04 and 2004-05 can be found in **Appendix XIII to Chapter Three**.

Although the costs of tax reliefs under Thai law have never been worked out, extensive tax exemptions have resulted in inadequate government revenue.[780] It is suggested that the costs of tax reliefs be worked out annually in order that "policy makers are fully aware of the financial impact of [tax reliefs]."[781]

The income-tax base should be broadened by limiting tax reliefs in order to maintain the revenue-raising role. In the previous section, proposals were made for the limitation of tax reliefs for equity. If the proposed limitation were implemented,

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charitable donations without ceiling is unlikely to lead to tax avoidance or tax arbitrage.

[777] Javad Khalilzadeh-Shirazi and Anwar Shah, "Introduction and Overview", Tax Policy in Developing Countries, Javad Khalilzadeh-Shirazi and Anwar Shah, eds. (Washington, D.C.: The World Bank, 1991), xviii

[778] Pond, op.cit.(note609), p.53

[779] Saatchi, op.cit.(note721), p.78

[780] Richupan, op.cit.(note512), pp.15-16

[781] The World Bank, op.cit.(note262), p.27

both revenue and equity purposes would probably be achieved. According to my proposal, tax reliefs can be limited as follows:

(i) phasing out personal allowances for some high-income taxpayers (under both laws),

(ii) abolishing the standard deduction and applying a deduction of actual expenses for all categories of income (except for savings and dividends income) under Thai law, and

(iii) removing certain tax exemptions and itemized deductions (under both laws).

There is evidence showing that the abolition of certain tax reliefs could increase tax revenue and promote equity. For instance, in Thailand prior to 1982, proceeds from the sale of an immovable property which was not acquired for the purpose of trade or obtaining profit was tax exempt. However, "the abolition of [this] exemption in 1982 was a direction towards income redistribution and also generates higher tax revenues for the government."[782] In the UK, when the mortgage tax relief and the married couple's allowance for younger couples were abolished, the income of the top 10% was reduced.[783]

3.2 Administrative and compliance costs

3.2.1 Complex tax system

There are five factors in the structure of the income-tax base that complicate the PIT system.

The number of relief provisions is the primary factor. As Sandford notes that "the UK income tax is complicated by many and complex reliefs."[784]

Secondly, the PIT system becomes complex because it is used (through both structural and non-structural reliefs) for many purposes, i.e. equity, and other economic and social purposes.[785]

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[782] Sussangkarn et al., op.cit.(note23), pp.16-17

[783] BBCNews/Budget2000/Tacking tax inequalities, http://news.bbc.co.uk, as of 10/3/2000, p.1

[784] Sandford, op.cit.(note58), p.154

[785] e.g. the increasing number of Thai tax reliefs has been used to stimulate the country's economic system following economic recession since 1977.

Thirdly, the inherent characteristics of tax reliefs bring about complexity. The availability of personal allowances depends on differences in taxable capacity. Older people, blind people and people with dependent children, for example, have less taxable capacity, so can claim more personal allowances. However, "differences in individual and family circumstances have resulted in a complex code of personal income taxation."[786] For example, although the provisions relating to age-related allowances and the income limit promote equity, they complicate the tax code. The blind person's allowance also increases the complexity of UK law.[787] Additionally, tax expenditures complicate the system.[788]

Fourthly, if personal allowances were too low, more poor people would become taxpayers, and if they were not adjusted for price inflation, more poor people would become taxpayers. A greater number of small-income taxpayers complicates tax administration.

Finally, tax expenditures provide large loopholes for tax avoidance. The PIT system becomes more complex when complex anti-avoidance provisions are introduced. Similarly, "attempts by the authorities to prevent evasion and avoidance lead to more complicated tax law."[789]

A complex tax system arising from the structure of the income-tax base increases administrative costs. For example, tax exemptions increase "monitoring costs on the part of the [Thai] government."[790] Likewise, administering exemptions and allowances incurs an additional cost of collection.[791]

A complex tax system arising from the structure of the income-tax base also increases compliance costs. As a result of complex tax reliefs under the UK law, the Institute for Fiscal Studies, as referred to in Saatchi, says, "it is now 'extremely difficult' for people to calculate how much tax they are due to pay."[792]

As noted earlier, if the personal allowances are low and not adjusted for price inflation, more small-income people will become taxpayers. Administration costs

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[786] Hockley, op.cit.(note315), p.207
[787] Barr et al., op.cit.(note577), p.16
[788] Sandford, op.cit.(note195), p.46
[789] Barr et al., op.cit.(note577), p.11
[790] Sahasakul, op.cit.(note257), p.25
[791] Dalton, op.cit.(note30), p.113
[792] Saatchi, op.cit.(note721), p.77

may be increased disproportionate to the tax collected, because tax gatherers have to deal with a greater number of small-income taxpayers, but collect only tiny amounts of tax. Meanwhile, these small-income taxpayers "will tend to incur compliance costs that are disproportionate to the tax they pay."[793]

Non-compliance costs may also be incurred by complex legislation. Complex tax reliefs result in different tax treatment of taxpayers with equal income. Consequently, dishonest taxpayers may spend extra resources searching for tax loopholes in complex legislation.

High administrative and compliance costs mean a large loss of tax revenue. To reduce costs in the taxing process, the PIT system should be made simpler for administration and compliance by modification of the structure of the income-tax base. To do this, authorities should:

(i) eliminate certain tax expenditures,

(ii) increase personal allowances to cover the costs of living and to be in line with price inflation.

As regards measure (i), the OECD has found that "most governments have been keen to reduce tax expenditures because they introduce added complexity in the tax system."[794] However, we cannot remove all tax expenditures because "there are, for some [tax expenditures], strong administrative reasons."[795] Similarly, "there are numerous exceptions to the bases for the various taxes, based on a mixture of practicality and expediency."[796]

The exception of certain fringe benefits can be justified on grounds of expediency because they are difficult to measure or administer. The exemption of farm income under Thai law can also be justified on grounds of expediency, because Thai farmers keep "very inadequate records [of income]."[797]

Tax expenditures that cannot be justified on grounds of expediency should be removed. This will not only lessen the complexity of the structure of the tax base but also facilitate administration and compliance. Furthermore, the elimination of certain tax expenditures facilitates administration and compliance because it is harder for

[793] The World Bank Group, op.cit.(note162), p.2
[794] OECD, Spending via the tax system, http://www.oecd.org/daf/fa/stats/spend.htm,as of 14/12/00, 1.
[795] Atkinson and Stiglitz, op.cit.(note407), p.64
[796] Tiley, op.cit.(note141), p.25

dishonest taxpayers to find loopholes to avoid or evade the tax[798], and it is simpler for honest taxpayers not to comply with many anti-avoidance rules.

If the personal allowances are increased according to **measure (ii)**, fewer low-income earners will become taxpayers and be required to file returns. This will reduce compliance and administrative costs.

3.2.2 Tax avoidance and evasion

Tax reliefs provide incentives for tax avoidance and evasion, which increase administrative and compliance costs and generate revenue loss.

Astin argues that "tax avoidance may involve not only the transformation of income but the exploitation of reliefs and allowances."[799] The exemptions of capital gains and interest income as well as interest deductibility may provide incentives for higher-income earners to manipulate their capital income (under contrived schemes)to receive favorable tax treatment and to exploit interest deductibility. Additionally, tax expenditures that are likely to provide incentives for tax avoidance include:

(a) the deductibility of life insurance premiums (under Thai law),
(b) the deductibility of contributions to personal pension funds (under both laws),
(c) the exemption of inheritance (under Thai law),
(d) the exemption of certain fringe benefits (under both laws),
(e) the exemption of per diem (under Thai law).

Tax reliefs under (a), (b), and (c) provide incentives for taxpayers to manipulate their capital income to receive favorable tax treatment. Those under (d) and (e) provide incentives for employees to shift to jobs that can offer non-taxable emoluments.[800]

Additionally, a standard deduction of expenses provides incentives for tax avoidance. Differences in the percentage of standard deduction between income from different sources may cause taxpayers to manipulate their tax affairs from low

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797 Lent and Hirao, op.cit.(note185), p.28
798 The World Bank, op.cit.(note262), p.39
799 Astin, op.cit.(note118), p.163
800 Prest, op.cit.(note40), p.270

percentage to higher percentage deduction. Similarly, "the different tax treatment of different sources of income [is] among the factors which enable some citizens to avoid or reduce their tax bill."[801]

In 2.2.2, the Thai government is recommended to abolish the standard deduction and apply a deduction of actual expenses for equity. This is likely to help achieve efficiency as well as equity. However, it may lead to tax evasion by taxpayers overstating expense deductions, producing false evidence of expenses, and bribing tax-gatherers. Therefore, it is further recommended to apply a deduction of actual expenses in Thailand together with improvements in tax enforcement, especially the enforcement of taxpayers to keep accounts and records, and severe punishments for bribery.

Tax evasion may also result from tax expenditures, i.e. taxpayers may misrepresent income and payments in order to exploit exempted income and itemized deductions.[802]

Tax avoidance and evasion generate high administrative and compliance costs, and a large loss of tax revenue. The abolition of reliefs that are tax loopholes can reduce incentives to avoid and evade the tax, which will bring about lower administrative and compliance costs, and greater tax revenue. These reliefs include the abolition of standard deductions, the exemptions of capital gains, interest income, fringe benefits and per diem, and the deductions of personal interest, life insurance premiums and contributions to personal pension funds.

3.3 Deadweight loss

Tax reliefs reduce taxable income and the tax burden. Therefore, people may take up tax-free or tax-preferred activities in place of taxed activities. Similarly, tax reliefs produce distortions in resource reallocation, resulting in deadweight loss.

Personal allowances may have work disincentive effects. If personal allowances were neither increased to cover the costs of living nor adjusted for price inflation, more poor people would become taxpayers. Low-income earners may decide to live on state benefits rather than enter the labor force.

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[801] OECD, op.cit.(note70), pp.43-44
[802] Thirsk, op.cit.(note64), p.17

Expense deductions may distort incentives to engage in economic activity. People may choose economic activities in which they can claim a high percentage of standard deduction.

Tax expenditures are introduced to promote particular economic activities by discharging or reducing the tax burden on particular individuals. Consequently, individuals may reallocate resources to tax-preferred activities. Tax expenditures that are likely to distort resource reallocation include:

(a) the exemption of certain fringe benefits (under both laws),
(b) the deductibility of contributions to personal pension funds (under both laws),
(c) the deductibility of life insurance premiums (under Thai law),
(d) the exemption of interest or returns on certain forms of savings accounts/ financial products (under both laws),
(e) the deductibility of mortgage interest payment (under Thai law), and
(f) the exemption of certain capital gains (under Thai law).

Tax expenditure under (a) distorts the choice of jobs and reallocation of human resources for three reasons. Firstly, individuals may seek, or shift to, a job that provides tax-free fringe benefits as a large part of their remuneration.[803] Secondly, employees may demand higher remuneration in the form of tax-free fringe benefits.[804] Finally, firms may induce individuals to work for them by offering these.[805]

Tax expenditures under (b) and (c) discriminate against other forms of saving on which interest earned is taxed.[806] Consequently, there is an unnatural incentive for individuals to transfer their current income to pension and insurance schemes for future income.[807] Therefore, these tax expenditures distort savings decisions.[808]

Tax expenditure under (d) distorts the choice of savings and investment. It discriminates against forms of savings and investment on which interest or returns are taxed. Trotman-Dickenson points out that "by exempting from tax income

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803 Messere, op.cit.(note240), p.230
804 Stotsky, op.cit.(note509), p.122
805 Messere, op.cit.(note240), p.230
806 ibid.p.232
807 ibid.p.227
808 ibid.p.233

derived from certain forms of investments, e.g. national savings certificates, a government can increase the appeal to investors of its own stocks and thereby discriminate against shares of companies."[809]

Tax expenditure under (e) distorts savings and investment decisions. According to Whitehead, in Sandford, "tax concessions to house owners raise the value of houses, providing a capital gain to present owners but reducing the capacity of would-be purchasers to buy their first house."[810] That is, the mortgage interest tax relief discriminates in favor of home ownership because

(a) it increases "the demand and therefore the price of housing";[811]

(b) "the beneficiaries were those who already owned houses when the relief was introduced, rather than those who sought to purchase them."[812]

This may provide an unnatural incentive for individuals to switch savings into investment in houses. Furthermore, tax reliefs given to housing (as well as to insurance policies and pension funds) provide incentives to reallocate resources to "safe and rentier-type investments"[813] rather than to "innovation and risk-taking."[814]

Tax expenditure under (f) distorts investment decisions, discriminating in favour of certain forms of investment from which the gains are non-taxable, for example, gains deriving from the sale of securities listed on the Stock Exchange of Thailand. There is therefore an unnatural incentive for individuals to reallocate resources to tax-preferred sources of capital gains.

Altogether, tax reliefs provide artificial incentives to reallocate resources to tax-free or tax-preferred activities. The World Bank notes that "distortions in resource allocation arising as individuals respond to the tax structure" are regarded as deadweight loss.[815]

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[809] Trotman-Dickenson, op.cit.(note138), p.105
[810] Cedric Sandford, "Taxation and Social Policy: An Overview", Taxation and Social Policy, Cedric Sandford, Chris Pond and Robert Walker, eds., (London: Heinemann Educational Books Ltd., 1980), 4-5
[811] James and Nobes, op.cit.(note5), p.88
[812] ibid.p.88
[813] Sandford, op.cit.(note810), p.8
[814] ibid.p.8
[815] The World Bank Group, op.cit.(note162), p.1

The least interference of the PIT with economic decisions is likely to counteract the distortion of the PIT in incentives. Therefore, the following measures are recommended: -

(i) an increase in personal allowances to cover the costs of living and to be in line with price inflation,

(ii) abolition of standard deductions, and

(iii) elimination of certain tax expenditures.

Raising the tax threshold under measure (i) will move more small-income taxpayers out of the PIT system. Consequently, work disincentive effects should decrease.

As regards measure (ii), this will reduce the distortion in incentives to engage in economic activities. The deduction of actual expenses to replace standard deductions is unlikely to distort such incentives. It is, however, argued that the deduction of actual expenses also affects decisions on the choice of jobs if the law allows a greater deductible expense for one than another. As James and Nobes note,

> "[In] practice more deductions are available to the self-employed than to employees. In effect, this can mean that self-employment income is taxed at lower rates. The result again may be a reallocation of resources. In this case, individuals may seek to become self-employed, even though from an economic viewpoint it might be more efficient for them to work as employees."[816]

They further suggest that "the Inland Revenue, of course, also has the additional task of ensuring that taxpayers do not manipulate their employment status illegally."[817] As we have seen in 2.2.2, in terms of equity, it is impossible for legislation to allow the same deductible expenses for different economic activities. It is correct to allow the self-employed to claim more deductible expenses than employees. Therefore, I agree with the suggestion by James and Nobes.

Finally, the abolition of certain tax expenditures under measure (iii) will reduce distortions in resource reallocation. Tax expenditures that should be removed

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[816] James and Nobes, op.cit.(note5), p.33
[817] ibid.p.179

include those mentioned under (a)-(f) above. There are arguments for and against this measure as discussed below.

Chappel in Nightingale suggests that to achieve neutrality "perks, privileges and allowances should be phased out", and "the system should not distort between different forms of saving and ideally there should be no distortion between spending and saving."[818] The OECD states that "most governments have been keen to reduce tax expenditures because they distort consumption, savings and investment decisions."[819] For example, the abolition of mortgage interest tax relief has helped remove economic distortions since the mid 1980s.[820] The UK government abolished mortgage interest tax relief on the grounds that the abolition would "remove a distortion in the housing market"[821], and would "improve the functioning of the housing market and contribute to the long-term stability of the economy."[822]

Conversely, the Thai government has been in favor of mortgage interest tax relief.[823] Valaisathien proposes that the amount of this relief should be increased from 50,000 to 300,000 baht because this would encourage saving in the form of home equity and borrowing to buy houses which would also stimulate real estate business during the economic recession in Thailand.[824] However, according to my analysis, the Thai government should consider the abolition of this tax relief to solve both the equity problem and the problem of economic distortions.

There are three other arguments against the removal of certain tax expenditures in spite of distortions in resource reallocation. That is, there are arguments for tax expenditures that can be used to encourage (a) socially beneficial activities, (b) domestic saving, and (c) risk-taking.

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[818] Nightingale, op.cit.(note65), p.51
[819] OECD, op.cit.(note794), p.1
[820] Nightingale, op.cit.(note65), p.50
[821] Author not identified, Simon's Direct Tax Service, Budget Bulletin Tuesday 9 March 1999, 39.
[822] HM Treasury, Financial Statement and Budget Report March 1999, http://archive.treasury.gov.uk/budget/1999/fsbr/29805.htm,as of 11/05/02, 11.
[823] In addition to an allowance for mortgage interest payment of 10,000 baht, income paid as mortgage interest on a housing loan (the part exceeding 10,000 baht but not exceeding 50,000 baht) is tax exempt. The provision of tax exemption was enacted in 2000 (during the recession).
[824] Suvarn Valaisathien, To overcome tax problems, 2nd ed. (Bangkok: Nititham Publishing, 2001), 152.

Socially beneficial activities

Certain tax expenditures are believed to provide incentives to reallocate resources to beneficial activities. As Stotsky notes,

> "The rationale for allowing charitable contributions, educational expenses, pension contributions, and life insurance contributions, to be deducted rests primarily on the argument that the deduction encourages a higher level of these activities and they are socially beneficial activities."[825]

Tax deductions under Thai law are introduced on the same argument as Stotsky's. As Trachudham notes,

(a) the deduction of life insurance premiums is meant to encourage saving and security for individuals and their families;

(b) the deduction of contributions to the Provident Fund is meant to encourage saving and investment;

(c) the deduction of educational expenses is meant to promote education; and

(d) the deduction of charitable donations is meant to promote generosity in society.[826]

In 2.2.3, it was stated that tax allowances for charitable donations and for the education of children should not be removed for reasons of equity because they encourage activities which benefit low-income groups. Although such reliefs may provide incentives to reallocate resources to charitable and educational activities, they should not be removed because reasons of equity outweigh distortions in resource reallocation.

In 2.2.3, it was stated that tax allowances for life insurance premiums and for pension contributions should be removed for equity since the former relief benefits high-income groups, while the latter adds to an individual's net worth. In this subsection, I have found that these reliefs should be abolished for efficiency, i.e. they distort savings decisions. Therefore, despite the argument that such reliefs are socially beneficial, they should be abolished for reasons of both equity and efficiency.[827]

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[825] Stotsky, op.cit.(note509), p.123

[826] Trachudham, op.cit.(note512), p.150

[827] Valaisathien seems to support the abolition of an allowance for life insurance premiums. As he notes,

Domestic saving

There is an argument referred to in Richupan that if interest income were included in the tax base, "net yield of the interest earners [would] be reduced and savings [would] consequently be discouraged."[828] The exemption of interest income is believed to encourage savings. The arguments for the exemption of interest income to encourage savings include:

(a) tax exemption will ensure that "everyone has a nest egg for retirement or ill health, both to avoid poverty and to reduce the demands on the state's social welfare resources"[829],

(b) tax exemption will help "dependents who survived when a wage earner died"[830], and

(c) tax exemption will prevent mobility of capital income.

As regards (a) and (b), "savings by individuals – particularly individuals with limited incomes – are encouraged."[831]

As regards (c), it is supposed that capital mobility results from the globalization of the world economy and the development of global financial and capital markets. Thirsk notes that "fear of capital flight and the inability to tax residents' worldwide income have persuaded a number of countries to exempt interest income from the [PIT]."[832]

Thirsk further notes that the favorable treatment of interest income due to the fear of capital mobility probably leads to the exemption of other forms of capital income, such as dividend income and capital gains. He explains that such exemptions will "mitigate the financial distortions that would otherwise occur."[833] Thailand has followed this pattern of tax treatment. Certain interest income and gains from the sale of securities in the Stock Exchange of Thailand are non-taxable. This pattern refutes my analysis. As analyzed earlier, the exemption of certain interest income and capital

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"A major part of the insurance premium goes to the broker. Therefore, if you put the premium in a saving account, you will end up with more money than what you get from the insurer."

Valaisathien, op.cit.(note824), p.181

828 Richupan, op.cit.(note512), p.17

829 Morse and Williams, op.cit.(note15), p.177

830 ibid.p.117

831 ibid.p.117

832 Thirsk, op.cit.(note64), p.10

gains distorts the choice of savings and investment because it discriminates against other forms of savings and investment. Slemrod, referred to in Steinmo, seems to support the pattern that Thirsk has found. According to Slemrod,

> "[Tax policy] has traditionally been thought of as an entirely domestic matter. [But] in an increasingly global world economy, nations can no longer afford to design their tax systems without accounting for the effects on international trade and investment."[834]

Nevertheless, the argument in favor of exemption of interest income may be weakened since tax exemption is unlikely to be the only factor to encourage saving in practice. In Chapter Two, it was established that there are other factors influencing the decline and the increase in saving, such as interest rates. Richupan supports the view that the argument that tax exemption can encourage savings is not valid because "the increase in the net yield on savings could be accomplished in another way, i.e. to increase interest rates on savings deposits."[835] Additionally, Gale notes that saving trends depend on "many factors other than tax policy."[836] He has also found that "the run-up in equity values, social security reform, budget deficits and other factors may also have played important roles in saving trends."[837] Furthermore, according to evidence presented by Banks, Blundell and Dilnot referred to in Gale, "TESSAs probably did not raise private saving much, if at all, and may well have reduced national saving."[838]

The arguments for the exemption of interest income to encourage the savings of individuals with limited incomes might also be weakened if interest income was taxed at the rates under the two tax-rate schedules as proposed in Chapter Two. This is because the interest income of such individuals would be subject to the 0% rate in the schedule for low-income groups, which would encourage such individuals to save without the exemption of interest income for all groups of people.

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[833] ibid.p.40
[834] Steinmo, op.cit.(note581), p.156
[835] Richupan, op.cit.(note512), p.17
[836] Gale, op.cit.(note718), p.355
[837] ibid.p.355
[838] ibid.p.356

Risk-taking

There is an argument referred to in Auerbach that "favourable capital gains treatment serves to encourage risk-taking, which is otherwise discriminated against by the income tax system."[839] This argument contradicts my analysis that the exemption of certain capital gains distorts investment decisions. Nevertheless, the argument in favor of exemption of capital gains may be weakened since tax exemption is unlikely to be the only factor to encourage risk-taking in practice. According to one of the investors in a survey conducted by Aharoni referred to in Morisset and Pirnia, "tax exemption is like a dessert; it is good to have, but it does not help very much if the meal is not there."[840] The survey concludes that "income tax exemption was considered a very weak stimulant; those investors, who did consider it, did it only marginally."[841]

Altogether, despite the argument against abolition of the exemptions of interest income and capital gains, these reliefs should be abolished. The abolition will solve both the equity problem and the problem of economic distortion.

4. Conflict between equity and efficiency, and proposed solutions

4.1 Structural reliefs and the conflict

Although personal allowances under existing Thai and UK laws help reduce the tax burden on low-income earners, they generate vertical inequity and negate tax progressivity. This is because:

(a) they also reduce the burden on high-income earners; and

(b) along with the progressive rate structure, high-income earners receive a larger proportionate reduction in the tax burden from personal allowances than low-income earners.

Additionally, personal allowances under both laws probably lead to inefficiency of taxation because:

(a) they lead to revenue loss;

(b) numerous items of personal allowances complicate the PIT system;

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[839] Auerbach, op.cit.(note489), p.605

[840] Morisset and Pirnia, op.cit.(note130), p.5

(c) the inherent characteristics of personal allowances bring about complexity in the PIT system;

(d) personal allowances which are too low and not adjusted in line with price inflation probably complicates tax administration; and

(e) personal allowances which are neither increased to cover the costs of living nor adjusted for price inflation probably cause more poor people to decide to live on state benefits.

The deduction of actual expenses under UK law is likely to satisfy the ability-to-pay principle and the concept of progressivity. Conversely, although a standard deduction of expense under Thai law reduces taxable income for low-income earners, it dissatisfies the ability-to-pay principle and the concept of tax progressivity.

A standard deduction dissatisfies the ability-to-pay principle because it undermines horizontal equity, i.e. differences in the percentage of standard deduction cause taxpayers with equal income (but from different sources) to pay different taxes. A standard deduction will also undermine vertical equity and tax progressivity because:

(a) it probably helps high-income taxpayers to deduct expenses exceeding the real costs of earning;

(b) along with the progressive rate structure, high-income taxpayers receive a greater proportionate reduction in the tax burden from a standard deduction than lower-income taxpayers; and

(c) a standard deduction lowers effective MTRs below statutory MTRs.

Additionally, deductible expenses probably lead to inefficiency of taxation because:

(a) revenue loss will probably occur if taxpayers deduct expenses exceeding the real costs of earning;

(b) differences in the percentage of standard deduction between income from different sources possibly provide incentives for tax avoidance and distort incentives to engage in economic activity because people may choose

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[841] ibid.p.5

economic activities in which they can claim a high percentage of standard deduction; and

(c) the deduction of actual expenses may lead to tax evasion by overstating expense deductions, producing false evidence of expenses, and bribing tax-gatherers.

4.2 Tax expenditures and the conflict

Although tax expenditures under existing Thai and UK laws reduce taxable income for low-income earners, they dissatisfy the ability-to-pay principle and the concept of tax progressivity. This is because:

(a) tax expenditures bring about horizontal inequity since exempt income and itemized deductions are only available to particular types of individual;

(b) tax expenditures bring about vertical inequity since:

(i) the poorest do not benefit from them;

(ii) the tax liability of high-income taxpayers is discharged or reduced as a result of tax expenditures;

(iii) tax expenditures may be intentionally or unintentionally designed to benefit high-income taxpayers; and

(iv) tax expenditures are legal loopholes for tax avoidance; and

(c) tax expenditures undercut tax progressivity since:

(i) the rich who derive exempt income receive a greater proportionate reduction in their tax burden than the poor;

(ii) high-income taxpayers tend to make larger payments than low-income taxpayers to have the benefit of itemized deduction; consequently, high-income taxpayers obtain a greater reduction in taxable income than low-income taxpayers; and

(iii) while itemized deductions reduce effective ATRs, high-income taxpayers receive a greater reduction in effective ATRs than low-income taxpayers.

Additionally, tax expenditures under both laws probably lead to inefficiency of taxation because:

(a) they reduce tax revenue since they discharge or reduce the tax burden on particular types of individuals and act as the tax shelter for the wealthy;
(b) numerous items of tax expenditure complicate the PIT system, and result in high administrative and compliance costs;
(c) the inherent characteristics of certain tax expenditures also bring about complexity in the PIT system;
(d) tax expenditures provide large loopholes for tax avoidance; and
(e) tax expenditures probably distort resource allocation, which generates deadweight loss.

4.3 Proposed solutions to the conflict (an optimal tax base)

As indicated in 4.1 and 4.2, tax reliefs are the major factor leading to the conflict between equity and efficiency. An optimal tax base should be established by limiting the use of tax reliefs.

4.3.1 Proposed structural reliefs

As discussed in 4.1, personal allowances and deductible expenses adversely affect equity and efficiency. This research proposes that these structural reliefs should be modified to help broaden the tax base, which will promote equity and efficiency simultaneously.

As regards the modification of personal allowances, two proposals are put forward, namely

(a) increasing personal allowances to cover private consumption expenditures per capita (under Thai and UK laws) and to be in line with price inflation (under Thai law), and
(b) phasing out personal allowances for the rich (under both laws).

The two proposals would have the following effects at the same time.

Firstly, the proposed personal allowances would not generate vertical inequity nor negate tax progressivity. This is because if personal allowances were increased and phased out according to the proposals above, their real value would be maintained to cover the real cost of a standard of living, which would reduce the tax burden on low-income earners (not on high-income earners). The proposed personal allowances would serve both lower and upper ends of the income scale, i.e. reducing the proportion of income paid in tax by low-income earners and increasing the proportion of income paid in tax by high-income earners. This would promote vertical equity.

Secondly, the proposed personal allowances would promote economic efficiency of taxation for the following reasons.

(i) Phasing out personal allowances for the rich means broadening the tax base for the rich, which would generate a greater amount of tax revenue, as discussed in 3.1.

(ii) If personal allowances were increased according to the proposal (a), this would simplify tax administration and compliance, which would reduce administrative and compliance costs. This is because more low-income earners would be moved out of the PIT system, as discussed in 3.2.1.

(iii) If personal allowances were increased according to the proposal (a), this would reduce work disincentive effects. This is because it would encourage low-income earners to enter the labor force rather than living on state benefits, as discussed in 3.3.

As regards the modification of deductible expenses, three proposals are made.

Firstly, the standard deduction (under Thai law) should be abolished. This would eliminate differences in the percentage of standard deduction (which cause horizontal inequity) and remove the greater number of tax benefits received by high-income taxpayers from the standard deduction (which causes vertical inequity and the negation of tax progressivity). It would also eliminate incentives for tax avoidance or resource allocation to economic activities in which taxpayers can claim a high percentage of standard deduction.

Secondly, a deduction of actual expenses should be applied for all sources of income (except for savings and dividends incomes) under both laws. A deduction of actual expenses (under suggestions made in 2.2.2.2) would not allow taxpayers to deduct expenses exceeding the real costs of earning nor distort incentives in resource allocation (as discussed in 3.3). This would promote horizontal and vertical equity, generate a greater amount of tax revenue, and reduce deadweight loss.

Thirdly, the enforcement of account and record keeping should be improved at the time of introducing a deduction of actual expenses in Thailand. This proposal would prevent tax evasion by overstatement of expense deductions, production of false evidence of expenses, and bribery of tax-gatherers.

4.3.2 Proposed tax expenditures

As exempt income and itemized deductions adversely affect equity and efficiency, they should be modified. Three proposals are made, namely:-

(a) the discontinuation of new tax expenditures that cannot be justified on the grounds of expediency (under both laws).

(b) the abolition of certain tax expenditures (under both laws), and

(c) the maintenance of certain tax expenditures (under both laws).

As regards (a), the exception of certain fringe benefits, for example, can be justified on grounds of expediency because they are difficult to measure or administer. Therefore, income that is not difficult to measure and administer should not be exempt from the PIT.

As regard (b), tax expenditures that should be abolished in order to promote equity and efficiency simultaneously include the following:

(a) the deduction of life insurance premiums and the exemption of income paid as life insurance premiums (under Thai law),

(b) the exemption of capital gains (under Thai law),

(c) the exemption of income paid for buying immovable property or paid as interest on loans to buy or invest in immovable property (under Thai law),

(d) the deduction of mortgage interest payment (under Thai law),

(e) the exemptions of any form of return on financial products or savings (under both laws),

(f) the exemption of prizes and winnings (under both laws),

(g) the exemptions of inheritance and proceeds from the sale of movable and certain kinds of immovable property acquired by inheritance (under Thai law),

(h) the exemption of the transfer of immovable property to the taxpayer's lawful child (under Thai law),

(i) the exemption of income from certain business activities (under Thai law),

(j) the exemption of certain foreigners' income working in Thailand (under Thai law),

(k) the exemption of fringe benefits which cannot be justified on grounds of expediency (under both laws),

(l) the deduction of contributions paid to personal pension funds (under both laws),

(m) the deduction of social security contributions (under Thai law),

Tax expenditures under (a)-(e) should be abolished because they benefit the rich more than the poor (as discussed in 2.2.3)[842], provide incentives for tax avoidance and evasion (as discussed in 2.2.3, 3.2.2), distort resource allocation (as discussed in 3.3), and lead to revenue loss (as discussed in 3.1). Meanwhile, tax expenditures under (f)-(m) should also be abolished because they increase the taxpayer's ability to pay (as discussed in 2.2.3) and lead to revenue loss (as discussed in 3.1). Additionally, some of them are likely to provide incentives for tax avoidance and evasion, and to distort resource allocation (as discussed in 3.2.2 and 3.3). Therefore, the abolition of tax expenditures under (a)-(m) is likely to promote both equity and efficiency simultaneously. The following are six prospective outcomes in terms of equity and efficiency from the abolition of these tax expenditures.

Firstly, the proposed abolition could reduce horizontal inequity. Similarly, horizontal equity can be achieved with "minimal use of exclusions and deductions."[843]

Secondly, the proposed abolition would reduce both vertical inequity and erosion in tax progressivity. As World Bank staff point out, "vertical equity increases because tax expenditures that offer disproportionate levels of benefits to the rich are curtailed."[844] Additionally, the IMF claims that "effective rate progressivity could be

[842] Another reason for abolishing tax expenditure under (b) is that it increases the taxpayer's ability to pay, as discussed in 2.2.3.

Other reasons for abolishing tax expenditure under (c) are that this tax expenditure increases the taxpayer's ability to pay and can be replaced by direct subsidy, as discussed in 2.2.3.

Other reasons for abolishing tax expenditure under (d) are that it can be replaced by direct subsidy and is not equivalent to revenue costs, as discussed in 2.2.3.

[843] Brunori, op.cit.(note261), 196 .

[844] Khalilzadeh-Shirazi and Shah, op.cit.(note777), p.xviii

improved by reducing exemptions and deductions."[845] The proposed abolition promotes vertical equity and tax progressivity because it would make the rich not only pay more but pay a greater proportion of their income in tax.

Thirdly, the proposed abolition would prevent tax avoidance and evasion. Sandford points out that "[the] more the exemptions, concessions, reliefs, etc accorded within a tax, the more opportunities for avoidance are created."[846] The abolition of tax expenditures means plugging tax loopholes, thereby preventing opportunities for tax avoidance. The abolition of tax expenditures also prevents tax evasion by misrepresenting income and payments in order to exploit exempt income and itemized deductions.[847] Thirsk supports the view that "fewer tax incentives [and] the development of broader tax bases can help make tax evasion both less feasible and less desirable."[848]

The prevention of tax avoidance and evasion would promote vertical equity because it would make the rich (who are believed to be more commonly tax avoiders and evaders than the poor) not only pay more but pay a greater proportion of their income in tax. In addition, it promotes economic efficiency of taxation. As the World Bank notes, the elimination of exemptions "can simplify administration by making it harder for taxpayers to evade their payment."[849] Similarly, extra government resources would not be needed to prevent and detect tax avoidance and evasion. In addition, honest taxpayers would not need to comply with too many anti-avoidance rules.

Fourthly, the proposed abolition means not only preventing tax avoidance and evasion but also broadening the tax base, which would increase tax revenue. Increased tax revenue would be further redistributed to the poorest through public expenditure or spent on improving or funding existing public services instead of borrowing money or introducing new forms of tax.

Fifthly, the proposed abolition could simplify the PIT system, thereby lowering administrative and compliance costs.

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[845] Tanzi and Zee, op.cit.(note108), p.6
[846] Sandford, op.cit.(note58), p.161
[847] Thirsk, op.cit.(note64), p.17
[848] ibid.p.25
[849] The World Bank, op.cit.(note112), p.39

Sixthly, the proposed abolition could reduce distortions in resource allocation to tax-preferred activities, thereby lowering deadweight loss.

As regards the maintenance of tax expenditures, tax expenditures that should be maintained are those proposed in 2.2.3, e.g. those which are equivalent of the costs of earning income, and those which are designed to benefit those with less taxable capacity. It may be argued that the maintenance of these tax expenditures adversely affects efficiency of taxation, by leading to revenue loss and deadweight loss. For example, the deduction of charitable donations and educational expenses for children distort resource reallocation to charitable and educational activities. Nevertheless, these tax expenditures should be maintained because reasons of equity outweigh these of inefficiency of taxation. The following are two prospective outcomes in terms of equity from the maintenance of these tax expenditures.

Firstly, the proposed maintenance is unlikely seriously to undermine horizontal equity because it is mainly made not only to help people with less taxable capacity but also for other reasons, i.e. promoting fairness (a) among persons[850], (b) in society[851], and (c) in taxation.[852] Consequently, although people with equal income may pay different tax, this can be justifiable if they are in different positions.

For example, as between two wage-earners with equal income, one who is married with three dependent children and receives tax relief for children's education will pay less tax than another who is single and childless (under Thai law). And between a pensioner and a wage-earner with equal income, the former receives a tax-free pension income, while the latter pays tax.

Secondly, the proposed maintenance could reduce the amount and proportion of income paid in tax of the poor. This would also promote vertical equity and tax progressivity. However, the rich might still benefit. This can be weakened on the grounds that the purpose of the proposed maintenance is not only to help the poor but for other reasons as mentioned above. It is therefore unavoidable that the rich might receive the benefit of tax expenditures such as the proposal for the removal of a

[850] For example, an individual whose tax capacity is reduced or disrupted by certain causes should not pay tax on income that offsets such reduction.

[851] For example, tax exemptions that can be justified on social and moral grounds and on promotion of socially important activities should be maintained.

[852] For example, the tax system should not lead to double taxation. Certain exemptions can prevent double taxation.

ceiling for the deduction of charitable donations (under Thai law), as discussed in 2.2.3.

However, in order to prevent rich taxpayers from receiving benefits from the proposed maintenance of tax expenditures, this research proposes that a ceiling be imposed on certain tax expenditures and that tax deduction be phased out for the rich. For instance, a ceiling should be imposed for the exemption of pension income (under both laws), and there should be no educational allowance for the rich (under Thai law). As the World Bank claims "if tax bases are properly redesigned, vertical equity can be improved."[853]

5. Conclusion

It is argued that the CIT could achieve both equity and efficiency.[854] However, there is a disagreement referred to in Tiley that the CIT idea is "the single idea of equity", which "could not accommodate ideas such as economic efficiency as part of its base."[855] This research has found that if the income-tax base were defined and reformed in line with the CIT idea, it would become an optimal tax base to achieve both equity and efficiency.

In theory, the CIT requires all types of item which amount to economic accretion to fall within the income-tax base. Therefore, if the terms of income subject to tax are defined broadly under the CIT idea, this will help broaden the income-tax base to achieve equity and efficiency.

However, the definition of income under the CIT idea has not been fully put into practice in many countries because of certain practical problems. This research has found that Thailand has adopted the CIT idea into the PIT law to a great extent because Thai law has given a definition of 'income subject to tax' in line with the CIT idea. However, this does not mean that the income-tax base under Thai law operates effectively to achieve equity and efficiency. This is due to many tax reliefs. Meanwhile, although there is no definition of income in UK law, this research has found that UK law has also adopted the CIT idea to a great extent. This is because UK law has many provisions on chargeable income, and Section 687 (1) of the

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[853] The World Bank, op.cit.(note112), p.26

[854] Auerbach, op.cit.(note489), p.605; and Nightingale, op.cit.(note65), p.51

ITTOIA 2005 can catch more income subject to tax. Nevertheless, the extensive use of tax reliefs adversely affects the widening of the UK tax base.

The use of tax reliefs under Thai and UK laws (i.e. structural reliefs and tax expenditures) prevents the income-tax base from becoming a broad-based tax or realizing the CIT idea. Although these tax reliefs help narrow the income-tax base and reduce taxable income for low-income earners, both cause horizontal and vertical inequity, the negation of tax progressivity, and inefficiency of taxation. This means that these tax reliefs cause conflict between equity and efficiency. Therefore, the income-tax base should be reformed to be consistent with the CIT idea and to become an optimal tax base. The proposed reform is to broaden the income-tax base by limiting the use of these tax reliefs.

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[855] Tiley, op.cit.(note141), p.13

Chapter Four

Optimal Tax Unit for Treatment of Married Couples

1. Introduction

The OECD points out that "the tax unit may be the individual, the couple, or the family."[856] The unit of income taxation under Thai law is the couple ("joint taxation"). Meanwhile, the individual is the tax unit under UK law ("individual taxation").

Most literature on the tax unit points out that the issue of the tax unit is complicated and controversial in tax policy.[857] The adoption of either joint or individual taxation raises anomalies in tax law and conflicting considerations in the PIT system.[858] The proper tax treatment of married couples, it has sometimes been proposed, should use the tax unit which provides compromises between equity and efficiency[859] or incorporates the best elements of both joint and individual taxation.[860] These proposals will be examined to see whether they can reduce the conflict between equity and efficiency.

2. Concepts of joint and individual taxation

2.1 Relevant taxing provisions

The main provision on the tax unit under Thai law is Section 57 ter of the RCT, i.e. the wife's income is treated as the husband's for income tax purposes if they have lived together throughout the tax year; and the husband has the duty and liability to file a return and pay tax. Thai law therefore treats the husband and wife as one tax entity[861] and adopts the basic structure of joint taxation.

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[856] OECD, op.cit.(note70), p.41

[857] The Musgraves, op.cit.(note5), p.366; Tiley, op.cit.(note141), p.151; and Janet Stotsky, "The Choice of Taxable Unit", Tax Policy Handbook, Parthasarathi Shome, ed. (Washington, D.C: IMF, 1995),129.

[858] IFS, op.cit.(note98), p.377; and Simon James, "The Reform of Personal Taxation: A Review Article", Accounting and Business Research, Volume 17, Number 66, Spring 1987, 119

[859] IFS, op.cit.(note98), p.378

[860] C N Morris and N A Warren, "Taxation of the Family", Fiscal Studies, Volume 2, Number 1, March 1981, 28.

[861] Ministry of Finance, op.cit.(note642), p.1

The previous unit of taxation of spouses in the UK was the couple. This is found in Section 37 of the TA 1970 and Section 279 of the TA 1988. The present tax unit in the UK is the individual. This results from Section 32 of the Finance Act 1988, in which it is stated:

> "Section 279 of the Taxes Act 1988 (which treats the income of a woman living with her husband as his income for income tax purposes) shall not have effect for the year 1990-91 or any subsequent year of assessment."

As a result of Section 32 of the Finance Act 1988, the system of individual taxation (which is also known as "independent taxation") has been in effect since 6 April 1990. Under this system, "a husband and wife will be taxed independently on income of all kinds."[862] A husband and wife are each responsible for dealing with the Revenue on their own tax affairs. Each spouse is entitled to his/her own personal tax allowance to set against his/her own income regardless of its sources.

2.2 Rationale for joint and individual taxation

Arguments for joint taxation

Family values

The family is deemed to be the basic social unit and the basic economic unit in society.[863] A husband and wife earn and pool their income. Afterwards their spending is done from their common budget.[864] Likewise, spouses share the material benefits and standard of living from their income[865], and they have joint consumption within the family.[866] Income earned by both spouses is then regarded as that of the family. Thus, the family/couple should be taken as the unit of taxation for married couples.

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862 The Chancellor of the Exchequer, the Rt Hon Nigel Lawson MP, Budget Speech, 15 March 1988
863 Tiley, op.cit.(note141), p.153;
The 1966 Carter Commission in Canada quoted in Messere (Messere, op.cit.(note240), p.255); and The 1966 Report of the Royal Commission quoted in Rosen (Rosen, op.cit.(note250), p.365)
864 OECD, The Treatment of Family Units in OECD Member Countries under Tax and Transfer Systems, (Paris: OECD, 1977), para.56
865 Tiley, op.cit.(note141), p.154; and Morris and Warren, op.cit.(note860), pp.28-29
866 Janet G. Stotsky, How Tax Systems Treat Men and Women Differently, www.worldbank.org/fandd/english/0397/articles/070397.htm, 6.

Dependency

The second argument is based on the idea of dependency of a married woman upon her husband.[867] Married men are the key earners outside the home and take responsibility for their wives' welfare.[868] Meanwhile, most married women stay at home looking after the children: few wives go out to work.[869] The wife is regarded as the second earner of the household.[870] Therefore, the husband should be responsible for the tax affairs of both.[871]

Tax revenue

Joint taxation is believed to help raise more tax revenue because the aggregated income is raised to a higher tax band and will increase tax revenue.

Fair tax burden

It is argued that joint taxation can produce an equitable distribution of tax burdens among households.[872] Many agree and call for the same tax treatment of married couples with the same joint incomes.[873] Joint taxation can work to succeed in this requirement. More discussion will be supplied on this point later.

A couple as one person

This argument favours the adoption of joint taxation in Thai law. Joint taxation corresponds with the provision of the Civil and Commercial Code of Thailand ("the CCCT") relating to the legal status of a husband and wife. Under the CCCT, a husband and wife are regarded as one person.[874]

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867 IFS, op.cit.(note98), p.377
868 ibid.p.377
869 ibid.p.377
870 Tiley, op.cit.(note141), p.155
871 This argument can be refuted on the grounds that married women go out to work in the same way as married men in the current economic and social climate of many countries.
872 J.A. Kay and C. Sandler, "The Taxation of Husband and Wife: A View of the Debate in the Green Paper", Fiscal Studies, Volume 3, Number 3, November 1982, 174.
873 IFS, op.cit.(note98), p.378; Rosen, op.cit.(note250), p.363; and Morris and Warren, op.cit (note860), p.41

Arguments for individual taxation

Gender equality

There is an increasing number of married women in paid employment or otherwise economically active.[875] Married women require to achieve the same equality in the tax system as in other matters. It has been argued that individual taxation "has particular value in recognising gender equality [and] ensures that the tax system treats women in the same way as men."[876]

Privacy and independence

Under individual taxation, wives have privacy and independence in dealing with their tax affairs because they can look after their tax affairs. Young supports this view that "from a feminist perspective, the recognition of the autonomy of women is the strongest argument in favour of the individual as the unit of taxation."[877]

Tax neutrality

Rosen points out that "the tax system should be marriage neutral."[878] A tax is marriage neutral if the tax burdens of two single taxpayers do not change after marriage.[879]

A tax that is not neutral may distort taxpayers' decisions on marriage and possibly deter marriage.[880] The Meade Report also agrees, "the decision to marry or not to marry should not be affected by tax considerations."[881] As noted earlier, under joint taxation, married couples pay more tax than they did as two single adults[882]because combined incomes are raised to higher tax bands. Thus, joint taxation is not marriage neutral, and it is considered a tax penalty on marriage.[883]

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[874] Viroj Laohapun, Income Tax Avoidance and Evasion in Thailand (Bangkok: National Defence College, 1980), 194.

[875] Ruth Lister, "Taxation, Women and the Family", Taxation and Social Policy, Cedric Sandford, Chris Pond and Robert Walke, eds. (London: Heinemann Educational Books, 1980), 138; and Peter Curwen, "Spending, Taxing and Borrowing", Understanding the UK Economy, 3rd ed., Peter Curwen, ed. (Hampshire: The Macmillen Press, 1994), 161.

[876] The Commission on Taxation and Citizenship, op.cit.(note22), p.106

[877] Claire Young, "Taxing Times for Women: Feminism confronts Tax Policy", Tax Conversation: A Guide to the Key Issues in the Tax Reform Debate, Richard Krever, ed. (London: Kluwer Law International, 1997), 264.

[878] Rosen, op.cit.(note250), p.363

[879] Stotsky, op.cit.(note857), p.125

[880] The Musgraves, op.cit.(note5), p. 367

[881] IFS, op.cit.(note98), p.378

[882] Lawson, op.cit.(note862); and Sandford, op.cit.(note195), p.56

[883] Lawson, op.cit.(note862); and the Musgraves, op.cit.(note5), p.367

Individual taxation is advocated as a possible means of removing such a tax penalty.[884] It is marriage neutral as it no longer refers to the combined income of spouses.

Incentive to work

Individual taxation is likely to provide wives with an incentive to earn outside the home because the wife's income will not be taxed at her husband's MTR since there is no aggregation of both spouses' income.

3. Effects of joint and individual taxation on equity

The choice of tax unit for the treatment of married couples should respond to the requirements of both horizontal and vertical equity.

According to Young,

> "The issue of what is the appropriate unit for income tax purposes has generated a significant body of literature. Much of this debate has focused on criteria such as horizontal and vertical equity.... to the question of what the appropriate unit should be.[885]

Many agree that the taxation of married couples concerns horizontal equity, i.e. married couples with equal incomes to be taxed equally.[886] However, it is also related to vertical equity, i.e. married couples with different taxable capacity should pay different tax. Furthermore, it is argued that an income tax system should be fair between different groups.[887] Similarly, single and married persons with equal incomes should receive equal tax treatment.[888] Messere proposes that, "governments have to decide what should be the relationship between the taxes paid by single and married taxpayers with the same level of pre-tax income."[889]

Thus, (a) a comparison of the taxable capacity of the same and different groups of taxpayers and (b) a comparison of the tax treatment of low- and high-

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[884] Financial Statement: The Budget Tax Proposals, Simon's Tax Intelligence (London: Butterworths, 1988), 151.

[885] Young, op.cit.(note877), p.263

[886] For example, Young, op.cit.(note877), p.378; Gale, op.cit.(note718), p.351; Rosen, op.cit.(note250), p.363; Tiley, op.cit.(note141), p.153; James, op.cit.(note858), p.119; the Musgraves, op.cit.(note5), p.366; and Morris and Warren, op.cit.(note860), p.41

[887] Morris and Warren, op.cit.(note860), p.41

[888] Sandford, op.cit.(note195), p.55

[889] Messere, op.cit.(note240), p.252

income married couples are required to consider to what extent joint and individual taxation achieve equity.

3.1 Tax treatment of couples and singles

A comparison of taxable capacity will be made between the following groups of taxpayers: -

(i) two-earner **vs.** two-earner married couples,

(ii) one-earner **vs.** two-earner married couples,

(iii) one-earner **vs.** one-earner married couples,

(iv) two single persons living separately **vs.** a two-earner married couple,

(v) two single persons living separately **vs.** a one-earner married couple,

(vi) an unmarried couple **vs.** a married couple,

(vii) an unmarried couple **vs.** two single persons living separately,

(viii) a single person **vs.** a one-earner married couple, and

(ix) a single person **vs.** a two-earner married couple.

Taxpayers that are brought into each comparison will have equal taxable incomes, but their taxable capacity may be the same or different. They may therefore pay the same or different tax. To achieve equity, the premises are (a) those with greater taxable capacity should be taxed more than those with less, and (b) those with equal taxable capacity should be taxed equally.

3.1.1 Comparison between two-earner married couples

Two married couples with both spouses working and with equal incomes (regardless of how much income is earned by each spouse) are regarded as having the same taxable capacity. This is because both couples have two partners to earn and to spend money, the same real income, and approximately the same costs of living. Married couples with the same income should be taxed equally.[890]

Joint taxation under Thai law achieves equity because it imposes equal taxes on two-earner married couples with equal incomes. Spencer also asserts, "a system that imposes the same tax burden on couples with the same joint income must be unit

[890] IFS, op.cit.(note98), p.378; the Musgraves, op.cit.(note5), p.366, Rosen, op.cit.(note250), p.363; James and Nobes, op.cit.(note5), p.161; and Stiglitz, op.cit.(note68), p.528

– (or household-) based."[891] Example 4.1 in **Appendix I to Chapter Four** helps clarify this point.

Conversely, individual taxation under UK law violates equity because it does not impose equal taxes on two-earner married couples with equal incomes. Rosen agrees that "individual filing would lead to a violation of the [equity] principle: equal taxation of families with equal incomes."[892]

Individual taxation produces different treatment of two-earner married couples, depending on the distribution of income between a couple.[893] Under this system, a married couple where spouses earn income equally pays less tax than a married couple in which the spouses earn income unequally. Example 4.2 in **Appendix I to Chapter Four** helps clarify this point.

3.1.2 Comparison between one-earner and two-earner married couples

Morris and Warren raise the question, "Are couples where income is equally earned by both partners similar to, or fundamentally different from, couples where similar income levels are achieved by the income of one partner alone?"[894]

The above question is related to the taxable capacity of one-earner and two-earner married couples, where both couples have the same joint income. Between two groups of married taxpayers, which has the greater taxable capacity? To answer these questions, there are two arguments to be taken into account.

Firstly, if one-earner and two-earner married couples have equal incomes, they can be regarded as having the same taxable capacity. Many agree that married couples with the same joint income should be taxed equally.[895] In comparing the taxable capacity of married couples, they concentrate on the aggregation of income received by married couples. According to the Musgraves,

> "The requirement is that equals should be treated equally. It need only be noted that it is a matter of indifference, for gauging ability to pay in the

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[891] N.S. Spencer, "Taxation of Husband and Wife: Lessons from Europe", Fiscal Studies, Volume 7, Number 3, August 1986, 84.
[892] Rosen, op.cit.(note250), p.366
[893] Stotsky, op.cit.(note857), p.125
[894] Morris and Warren, op.cit.(note860), p.29
[895] IFS, op.cit.(note98), p.378; the Musgraves, op.cit.(note5), p.366; Rosen, op.cit.(note250), p.363; James and Nobes, op.cit.(note5), p.161; and Stiglitz, op.cit.(note68), p.528

family-unit context, whether the given income is contributed by a single earner or by multiple earners."[896]

Secondly, it can be argued that one-earner and two-earner married couples have different taxable capacity, even though both couples have the same total income. This is because imputed income from housework by the non-earning member of a one-earner married couple and extra costs incurred by a two-earner married couple are taken into consideration.

For a couple with one spouse working outside the home, the other who stays at home can do housework, look after the children and enjoy leisure. Meanwhile, a couple with both spouses earning outside the home may employ someone to care for their children (if any) and to provide housekeeping services. If they provide household services themselves, they may lose some of their leisure time.[897] The value of childcare and housework done by the nonworking spouse who stays at home enhances the taxable capacity of a one-earner couple. This value is referred to as "imputed income"[898], "earned income in kind"[899], or "non-pecuniary income"[900] which should be considered as an accretion to taxable capacity.[901] An optimal economic approach also suggests that imputed income should be taken into account in designing the tax unit.[902] Meanwhile, extra costs such as childcare and housework costs or the forgone leisure time (where housework is done by the couple) lower the taxable capacity of a two-earner couple. Therefore, with equal incomes, a one-earner couple has a greater taxable capacity and should pay more tax than a two-earner couple.

I agree with the second argument. However, in certain circumstances, one-earner and two-earner married couples with equal incomes may not have different taxable capacity. As discussed above, some argue that the nonworking spouse can earn imputed income from the self-done housework and caring for children. However, such imputed income may not occur in the following circumstances.

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[896] The Musgraves, op.cit.(note5), p.366
[897] Young, op.cit.(note877), pp.267-268
[898] The Musgraves, op.cit.(note5), p.370
[899] Young, op.cit.(note877), pp.267-268
[900] James and Nobes, op.cit.(note5), p.161
[901] The Musgraves, op.cit.(note5), p.370
[902] Tiley, op.cit.(note141), p.155

(a) The nonworking spouse decides to stay at home because he/she is old or unhealthy and unable to do housework or care for children by himself/herself.

(b) Messere points out, "at high income levels, financial considerations may be secondary to the desire on the part of the wife to pursue a career."[903] On this basis, the wife of a wealthy man may stay at home; but with a lot of money to spend, she can afford to purchase household services or childcare expenses if there are children.

In the above circumstances, one-earner and two-earner couples with equal incomes have the same taxable capacity because both couples may require to pay for the same household services and the same childcare.

Where one-earner and two-earner couples with equal incomes are viewed to have the same taxable capacity, joint taxation can impose equal taxes on both couples. Thus, it does not violate equity. Example 4.3 in **Appendix II to Chapter Four** helps clarify this point. Conversely, individual taxation does not impose equal taxes on one-earner and two-earner couples with equal incomes. A one-earner couple pays more tax than a two-earner couple[904]because a progressive income tax will fall more heavily upon a couple with one earner than upon a couple in which each spouse earns income equally.[905] Thus, individual taxation violates equity. Example 4.4 in **Appendix II to Chapter Four** helps clarify this point.

In the case of the implied imputed income, one-earner and two-earner married couples with equal incomes are viewed to have different taxable capacity. In this case, individual taxation imposes unequal taxes on both couples, which does not violate equity. Conversely, joint taxation imposes equal taxes on both couples, which violates equity. Example 4.3 and Example 4.4 in Appendix II to Chapter Four help clarify this point.

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[903] Messere, op.cit.(note240), p.253

[904] Dalton, op.cit.(note30), p.96

3.1.3 Comparison between one-earner married couples

Many agree that married couples with equal incomes should be taxed equally.[906] One-earner married couples with equal incomes should therefore pay equal taxes.

It has been found that two married couples with one spouse working and with equal incomes have the same taxable capacity. This is because in both couples, they have the same real income and imputed income, and approximately the same costs of living.

Both joint and individual taxation can achieve equal taxation of one-earner couples. Therefore, there is no violation of equity. Example 4.5 and Example 4.6 in **Appendix III to Chapter Four** help clarify this point.

3.1.4 Comparison between two single persons living separately and a two-earner married couple

On the same income, a two-earner married couple can have more real income[907] or live more cheaply than two single persons living separately.[908] Similarly, the costs of two people living together "are much lower than twice the costs of two individuals living singly"[909] This is because a married couple shares accommodation and housekeeping services.[910] The share of household expenses or services generates "the economics of scale of joint living"[911], "economic benefits"[912], or "a higher standard of living"[913] to a married couple.

Thus, if two individual taxpayers have the same income before and after marriage, they will find that they have a greater taxable capacity and are subject to a higher tax after marriage.

Joint taxation can impose a higher tax on a married couple than if they were single adults living separately. Conversely, individual taxation imposes the same tax burden on two people whether as a married couple or as two single adults. Thus, Thai

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[905] ibid.p.96

[906] IFS, op.cit.(note98), p.378; the Musgraves, op.cit.(note5), p.366; Rosen, op.cit.(note250), p.363; James and Nobes, op.cit.(note5), p.161; and Stiglitz, op.cit.(note68), p.528

[907] The Musgraves, op.cit.(note5), p.367

[908] IFS, op.cit.(note98), p.378; and James and Nobes, op.cit.(note5), p.161

[909] Stiglitz, op.cit.(note68), p.528

[910] Lister, op.cit.(note875), p.139; and Tiley, op.cit.(note141), p.155

[911] The Musgraves, op.cit.(note5), p.367

[912] James and Nobes, op.cit.(note5), p.161

law is more likely to achieve equity than UK law. Similarly, James notes, "individual basis does not allow for the likelihood that a person's taxable capacity partly depends on his or her family arrangements."[914] Example 4.7 and Example 4.8 in **Appendix IV to Chapter Four** help clarify this point.

3.1.5 Comparison between two single persons living separately and a one-earner married couple

Where a married couple with one spouse earning outside and two single persons living separately have equal incomes, the former is likely to have a greater taxable capacity than the latter. If two people live together, their costs of living are lower than the combined costs of two people living separately.[915] Two people living together do not require two houses, two gardens etc. in the same way as two people living separately.

Furthermore, two people living separately have to go out to work and may not have enough time to do housework. Therefore, they may have to purchase household services (or, if they do housework themselves, they may lose some of their leisure time). Meanwhile, a married couple with one spouse staying at home may earn imputed income from housework. As James and Nobes note, "marriage will normally generate non-pecuniary income; a bachelor employs housekeeping and similar services."[916] Also, imputed or non-pecuniary income is non-taxable since it is "immeasurable."[917] Thus, imputed income increases the taxable capacity of a one-earner married couple. James and Nobes propose that "marriage [with non-pecuniary income] confers a greater taxable capacity, which on equity grounds, should be taxed."[918]

A one-earner married couple should therefore be taxed more than two single persons living separately, with equal incomes. Both joint and individual taxation can impose a heavier tax burden on the former than the latter.[919] Therefore, both achieve

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913 Tiley, op.cit.(note141), p.155
914 James, op.cit.(note858), p.119
915 Stiglitz, op.cit.(note68), p.528
916 James and Nobes, op.cit.(note5), p.162
917 Tiley, op.cit.(note141), p.155
918 James and Nobes, op.cit.(note5), p.162
919 However, with equal incomes, a one-earner married couple may be viewed to have a *slightly* greater taxable capacity than two persons living separately. This is because a non-earning spouse of

equity. Example 4.9 and Example 4.10 in **Appendix V to Chapter Four** help clarify this point.

The point to be further analyzed is the marriage penalty and marriage neutrality of joint taxation. As noted earlier, joint taxation is considered to impose a tax penalty on marriage and to be non-neutral with respect to marriage.[920] This is not correct in all respects. An increase in the tax burdens of two people takes place only in the case where, before marriage, two people live singly and earn outside income, and after marriage, the combined income of two people is lifted to a higher tax band. On the other hand, joint taxation does not increase the tax burdens of two people who are married to each other if, before marriage, one lives singly and earns outside income, while the other is dependent and does not earn. This means that joint taxation is marriage neutral and not a tax penalty in certain situations. This is illustrated in Example 4.11 in **Appendix V to Chapter Four**.

3.1.6 Comparison between an unmarried, cohabiting couple and a married couple

An unmarried couple with two partners working and a married couple with both spouses working, with equal incomes, have equal taxable capacity. Like a married couple, two people who cohabit can live more cheaply than two people who live separately.[921] An unmarried, cohabiting couple should then pay more tax than if they live singly.[922] Likewise, an unmarried couple should receive the same tax treatment as a married couple.

However, under joint taxation, an unmarried couple pays less tax than a married couple. Conversely, an unmarried couple pays the same tax as a married couple under individual taxation. Thus, individual taxation achieves equity, but joint taxation violates it. As Stotsky asserts, "tax systems that are based on joint taxation create inequalities in taxation between married and unmarried couples....with the

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the former may be old or unhealthy to do housework. Consequently, the former and the latter require to purchase the same household services. In this case, a one-earner married couple should have a *slightly* heavier tax burden imposed than two persons living separately. Nevertheless, under joint and individual taxation, a one-earner married couple may not have imposed a *slightly* heavier tax burden imposed than two persons living separately.

[920] This is because the tax burdens of two people increase after marriage.

[921] IFS, op.cit.(note98), p.377

[922] Stiglitz, op.cit.(note68), p.528

same income."[923] Example 4.12 and Example 4.13 in **Appendix VI to Chapter Four** help clarify this point.

3.1.7 Comparison between an unmarried couple and two single persons living separately

With equal incomes, two individuals working and cohabiting have a greater taxable capacity than two individuals working and living separately. Like a married couple, a cohabiting couple can live more cheaply than two persons living separately. This is because they share accommodation, household services and expenses, thereby reducing their cost of living.[924] A cohabiting couple should therefore be taxed more than two single persons living separately.[925]

Neither joint nor individual taxation systems can differentiate between the taxation of an unmarried couple and that of two persons living separately. Both groups of taxpayers, with the same joint income (but different taxable capacity), have the same taxes imposed under both systems. Therefore, both systems violate equity. According to Stotsky, "tax systems that are based on joint taxation create inequalities in taxation between....unmarried couples and individuals with the same income."[926] Example 4.14 and Example 4.15 in **Appendix VII to Chapter Four** help clarify this point.

3.1.8 Comparison between a single person and a one-earner married couple

With equal incomes, a single person has a greater taxable capacity than a one-earner married couple. Income earned by the former supports only one person, but income earned by the latter supports at least two persons. Therefore, the latter has a lower taxable capacity than the former. As James and Nobes assert, "if the wife (or husband) does not have paid employment, the remaining breadwinner has a dependent and therefore a lower taxable capacity."[927]

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[923] Stotsky, op.cit.(note857), p.129
[924] Stiglitz, op.cit.(note68), p.528; IFS, op.cit.(note98), p.377; and Lister, op.cit.(note875), p.139
[925] Stiglitz, op.cit.(note68), p.528; and Sandford, op.cit.(note195), p.55
[926] Stotsky, op.cit.(note857), p.129
[927] James and Nobes, op.cit.(note5), p.161

Similarly, a single person has lower costs of living than a married couple because a single person need not purchase as many goods and services as two people. The Musgraves give an example to support this as follows:

> "While certain consumption items (e.g. the light in the living room) serve two persons as well as one, others (e.g. chairs to sit on) are more costly for two."[928]

Even if a single person should pay more tax than a married couple, neither joint nor individual taxation systems satisfies this requirement. A single person pays the same tax as a married couple. Therefore, both systems violate equity. Example 4.16 and Example 4.17 in **Appendix VIII to Chapter Four** help clarify this point.

3.1.9 Comparison between a single person and a two-earner married couple

With equal incomes, a single person has a greater taxable capacity than a two-earner married couple because a single person has lower costs of living than a married couple. Therefore, a single person should pay more tax than a two-earner married couple. As the Musgraves assert, "among units with the same income, the unit with the smaller number should pay more."[929]

However, joint taxation imposes the same tax burden on a single person and a married couple. Conversely, individual taxation imposes a higher tax on a single person than a married couple. Accordingly, joint taxation violates equity, but individual taxation achieves it. Example 4.18 and Example 4.19 in **Appendix IX to Chapter Four** help clarify this point.

A summary of the taxable capacity of the same and different groups of taxpayers, and the operation of joint and individual taxation to achieve equity can be found in **Appendix X to Chapter Four**.

3.2 Tax treatment of low- and high-income married couples

The tax unit should impose a lower tax on worse-off married couples and a higher tax on better-off married couples in order to boost vertical equity/redistribution.

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[928] The Musgraves, op.cit.(note5), p.366
[929] ibid.p.366

3.2.1 Joint taxation helpful to redistribution

Under joint taxation, married couples pay more tax than they would as single adults. For this reason, many agree that joint taxation imposes tax penalties on marriage.[930]

Kay and King note, "aggregation of joint incomes involves a tax penalty [;] ..... [the] underlying concept is self-evidently anachronistic."[931] Additionally, according to Mr. Justice Asprey as referred to in Tiley,

> "Is it that it is considered more equitable that two persons, because they are married to each other, should each be more heavily taxed than if they were unmarried persons?"[932]

Gaow-kiow, the Thai academician, also criticizes the possibility that joint taxation discourages two people from getting married[933] because a married couple incurs greater expenses and responsibilities than two single persons, yet a married couple has to pay a heavier tax.[934]

Nevertheless, on equity and redistributive grounds, I would argue in favour of joint taxation in relation to certain aspects of the tax penalty. Although joint taxation imposes heavier tax burdens on married couples, this is not an absolute tax penalty. As analyzed in 3.2.4 and 3.2.5, a married couple has a greater taxable capacity and should therefore pay more tax than if they were single adults living separately. This analysis refutes Gaow-kiow's argument.

Furthermore, heavier tax burdens on high-income married couples can reinforce vertical equity/redistribution. Conversely, heavier tax burdens on low-income married couples undermine vertical equity/redistribution. Therefore, if joint taxation can impose a lower tax burden on low-income married couples, it will work perfectly to achieve vertical equity/redistribution.

In 1970, the IMF made a survey of Thailand's tax structure. Its report said that the use of the combined incomes of both spouses under joint taxation had imposed heavier tax burdens on married couples, not only wealthy couples but also

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[930] Lawson, op.cit.(note862); the Musgraves, op.cit.(note5), p.367; Stiglitz, op.cit.(note68), p.527; James and Nobes, op.cit.(note5), p.162; Sandford, op.cit.(note195), p.56; Hockley, op.cit.(note315), p.180; and Kay and King, op.cit.(note60), p.43

[931] Kay and King, op.cit.(note60), p.43

[932] Tiley, op.cit.(note141), p.152

[933] Permboon Gaow-kiow, "Paying income tax in the case where the income of a wife is treated as that of a husband", Dharmniti Tax Journal, Year No.15, Issue No. 176, May 1996, 94.

[934] ibid.p.94

poorer ones.[935] As discussed in Chapter Two, Thailand has now reduced tax rates and the number of tax bands as well as widening tax bands. Consequently, tax penalties on low-income married couples in Thailand have been reduced. In other words, the combined incomes of low-income married couples will be slightly raised to a higher tax band, and the combined incomes of (lower) middle-income married couples will not be raised to a higher tax band. This results from changes in the progressive rate structure. Consequently, the tax liabilities of low-income and (lower) middle-income married couples do not increase too much after marriage. Example 4.20 in **Appendix XI to Chapter Four** will clarify this point.

In addition, if the tax-rate schedule for low-income groups (which contains only two tax rates of 0% and 8%) in the proposed two tax-rate schedules (as discussed in Chapter Two) were put into practice, tax penalties on low-income and (lower) middle-income married couples in Thailand would be further reduced. In other words, the tax liabilities of low-income and (lower) middle-income married couples would increase slightly after marriage. Example 4.20 in **Appendix XI to Chapter Four** will clarify this point.

However, changes in the progressive rate structure under the present Thai tax-rate schedule also benefit (upper) middle-income and high-income married couples, but do not benefit the highest-income married couples. This is because the tax liabilities of (upper) middle-income and high-income married couples do not increase too much after marriage, but the tax liabilities of the highest-income married couples increase too much after marriage, as compared to the past. Example 4.21 in **Appendix XI to Chapter Four** will clarify this point. However, although the tax liabilities of (upper) middle-income and high-income married couples do not increase too much after marriage under the present Thai tax-rate schedule, they still pay more tax than if they would as single persons. This means that heavier tax burdens on (upper) middle-income and high-income marriage couples after marriage under the present Thai tax-rate schedule still promote vertical equity/redistribution.

In addition, if the tax-rate schedule for high-income groups (which contains only two tax rates of 8% and 15%) in the proposed two tax-rate schedules (as discussed in Chapter Two) were put into practice, (upper) middle-income, high-

[935] Lent and Hirao, op.cit.(note185), p.45

income and highest-income married couples would pay higher tax (after marriage) than if they would as single persons. It has also been found that after marriage, the tax liabilities of (upper) middle-income married couple would increase too much under the proposed two tax-rate schedules, as compared to their tax liabilities (after marriage) under the present Thai tax-rate schedule. But, after marriage, the tax liabilities of high-income and highest-income married couple would not increase too much under the proposed two tax-rate schedules, as compared to their tax liabilities (after marriage) under the present Thai tax-rate schedule. Nevertheless, (upper) middle-income, high-income and highest-income married couples would pay more tax under the proposed two tax-rate schedules than they pay under the present Thai tax-rate schedule. This would promote vertical equity/redistribution. Example 4.21 in **Appendix XI to Chapter Four** will clarify this point.

3.2.2 Individual taxation unhelpful to redistribution

As we have seen, under individual taxation, married couples pay the same tax as they would as single adults. Although the tax liabilities of worse-off couples do not increase after marriage, individual taxation does not help the progressive rate structure to achieve vertical equity/redistribution.

Firstly, wealthy couples benefit from individual taxation because they do not pay more tax after marriage. Many agree with this factor.[936]

Secondly, as the income of each spouse is taxed separately, wealthy couples may reduce their tax liabilities by inter-spousal transfer of investment income.[937]

Thus, individual taxation tends to benefit wealthy couples rather than low-income couples. The evidence, according to Messere, also indicates "generally separate taxation favours high income two-earner couples and penalises low income two-earner couples."[938]

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[936] Sandford, op.cit.(note195), p.124; Kay and King, op.cit.(note60), p.44; Kay and Sandler, op.cit.(note872), p.180; and Ken Messere, "An Overview", The Tax System in Industrialized Countries, Ken Messere, ed. (New York: Oxford University Press, 1998), 124.

[937] James and Nobes, op.cit.(note5), p.163; and Lister, op.cit.(note875), pp.141-142

3.2.3 Comparison between joint and individual taxation for redistribution

Joint taxation is more likely to help the progressive rate structure to reinforce vertical equity/redistribution than individual taxation in three ways.

Firstly, heavier tax burdens are still imposed on high-income couples after marriage.

Secondly, joint taxation does not encourage a reduction in tax liability by the transfer of income-producing property between spouses.

Finally, even though some low- and middle-income married couples still pay higher tax than they would as single people, in comparison with the past, tax burdens on such married couples have been lessened. The higher tax liability of married couples after marriage is the remaining problem in progressive taxation.[939] However, if this problem is looked at in terms of taxable capacity as discussed in 3.1.4, it does still exist. This is because a married couple has a greater taxable capacity and should pay more tax than two single persons living separately.

4. Effects of joint and individual taxation on efficiency

4.1 Administrative and compliance costs

The tax unit can reduce administrative and compliance costs by using simple rules and discouraging tax avoidance and evasion.

4.1.1 Simplicity and convenience

It is argued that the tax treatment of married couples should be "reasonably simple for the taxpayer to understand and for the tax authorities to administer."[940] This would reduce administrative and compliance costs.

4.1.1.1 Simple rules for administration

The rules of joint taxation under Thai law are simple for two reasons.

Firstly, there are only two sections relating to the taxation of spouses. As referred to earlier, Section 57 ter of the RCT deals with (a) the general rule of joint

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[938] Messere, op.cit.(note240), p.249
[939] Hockley, op.cit.(note315), p.180

income of both spouses and (b) the rule of spouses' election for separate assessment. Additionally, Section 57 quinque of the RCT lays down the rule on the wife's election for separate taxation of employment income.

Secondly, Thai law does not provide complicated rules to prevent tax avoidance by inter-spousal transfer.

Meanwhile, the present UK law is simpler to administer than the law pre 1990. This is due to there being a reduction in the tax provisions to be administered. The TA 1988 has two main rules for the taxation of spouses, which are:

(a) Section 282 concerning the construction of references to a husband and wife living together,

(b) Sections 282A and 282B concerning jointly held property, and

Additionally, the ITTOIA 2005 has two main rules concerning settlements (Sections 620 and 624) and outright gifts between a husband and wife (Section 626).

Morris and Warren note other aspects of simplification of individual taxation as follows:

> "The possibilities for simplification of the UK tax system which individual taxation would bring are quite extensive. Taxation of earned income under PAYE will then no longer need to keep track of the married status of each individual, or to make adjustments where the wife has paid too little, or too much tax."[941]

4.1.1.2 Simple rules for compliance

I agree with Morris and Warren when they write, "from the taxpayer's point of view, simple responsibility for his/her own tax will be easier to comprehend."[942] The rule that treats each spouse like a single taxpayer will help each spouse to understand and comply because:

(a) each spouse will comply with the law in the same way as he/she did before marriage;

(b) neither spouse has to take responsibility for the other spouse's tax affairs.

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[940] IFS, op.cit.(note98), p.378
[941] Morris and Warren, op.cit.(note860), p.39
[942] ibid.p.40

Compared to the rule of individual taxation, joint taxation gives a husband responsibility for his wife's tax in addition to his own tax. Therefore, it may be slightly difficult for a married man to comply with the rules of joint taxation. Meanwhile, the rules of joint taxation do not give a married woman much responsibility for dealing with her tax affairs.[943]

4.1.1.3 Convenience for administration

Joint taxation is convenient to administer because tax-gatherers deal with only one individual (i.e. a married man.)[944] However, it may cause some inconvenience to tax-gatherers who have to pay attention to each taxpayer's marital status. This is because if the husband fails to file a return and pay tax, tax-gatherers must send a notice to the wife to be jointly liable with the husband to settle the arrears.[945]

Individual taxation is also convenient to administer because "the Inland Revenue would no longer need to keep track of each taxpayer's marital status."[946] However, it may be inconvenient for tax-gatherers to administer since they have to deal with at least two individuals in one family.

4.1.1.4 Convenience for compliance

As noted above, joint taxation requires one tax return from one couple. This makes it straightforward for a couple to comply with. Laohapun supports the view that the aggregation of a wife's income with her husband's makes it convenient for taxpayers to file tax returns and pay taxes.[947] However, joint taxation may cause inconvenience for two reasons.

Firstly, wives are regarded as unable to declare their own income for tax.[948]

Secondly, if a wife does not tell her husband the full details of her income, a husband cannot compel her to make a full disclosure.[949] Consequently, the husband

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[943] A wife only has a duty to give the details of her income to her husband for making a tax return.
[944] Hugh McCrossan, Revision Workbook: Revenue Law, 2nd ed. (London: Old Bailey Press, 2000), 110.
[945] Section 57 ter, RCT
[946] James, op.cit.(note858), p.119
[947] Laohapun, op.cit.(note874), p.194
[948] Stotsky, op.cit.(note866), p.6
[949] This statement is summarized from George Bernard Shaw's letter to the tax-man in 1910. (Lister, op.cit.(note875), p.140)

may fail to declare his wife's income in full. Also, the husband may be unable to answer questions of tax-gatherers about his wife's income. The wife's failure to give full details of her income to the husband may lead to "a major marital upset".[950]

Conversely, individual taxation gives wives as much privacy and independence in their tax affairs as their husbands. This may compensate for any inconvenience.

4.1.2 Tax avoidance and evasion

4.1.2.1 Joint taxation and avoidance schemes

There are two possible forms of tax avoidance under joint taxation in Thailand.

Firstly, if two single persons are not married to each other, they may avoid paying a heavier tax by avoiding marriage, choosing to live together without registration of marriage.

Secondly, a married couple may avoid paying a heavier tax on their combined income by (a) getting a divorce at any time during the tax year and (b) not living together throughout the tax year.

The second method of tax avoidance results from the loophole in Section 57 ter. However, Mr. Justice Trachudham observes that Section 57 ter employs the words "a husband and wife live together throughout the tax year" instead of "a husband and wife's marital status exists throughout the tax year."[951] As a result of this loophole, a husband and wife do not need to divorce to avoid paying a heavier tax on their joint income, but only have to live separately in a permanent manner throughout the tax year. If a husband and wife occasionally live in different localities or occasionally live apart, they are deemed to live together and are still taxed on their joint income.[952]

I agree with Mr. Justice Trachudham that a married couple can avoid paying a heavier tax by living separately in a permanent manner throughout the tax year. This is because in interpreting the words used in the relevant tax provision, a strict interpretation is called for. But, if a husband and wife do not choose to live apart

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[950] James, op.cit.(note858)), p.118

[951] Trachudham, op.cit.(note512), pp.180-181

permanently, they still have alternative ways of avoiding tax by getting a divorce or living together without registration of marriage.

Besides tax avoidance, a married couple may evade payment of tax. A husband may (a) report false or inadequate information of his own income and/or his wife's income in his tax return, or (b) fail to file the tax return of his own income and/or of his wife's income.

4.1.2.2 Individual taxation and avoidance schemes

Under individual taxation, a married couple where both spouses earn income equally pays less tax than a married couple where spouses earn income unequally or one spouse earns all the income. Consequently, the transfer of some income from one spouse to another in order to equalize taxable income between spouses can reduce spouses' tax liabilities. In this regard, income will be transferred from a spouse who is subject to higher MTRs to another who is subject to lower MTRs or no tax.

Tax avoidance by inter-spousal transfer mostly occurs with investment income such as dividends, interest and rent. This point is well supported[953] because "it is much more difficult to transfer earned income to another before tax is paid."[954] In fact, the transfer of investment income to reduce tax liability is the transfer between spouses of ownership of property such as shares, bank accounts, land and buildings. This property is referred to as "income-yielding property"[955], "income-producing investment"[956], or "the associated income-earning assets."[957] The ownership of such property is not difficult to transfer before tax is paid in practice.

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952 The last Paragraph, Section 57 ter, the RCT

953 The Musgraves, op.cit.(note5), p.369; Rosen, op.cit.(note250), p.365; Gale, op.cit.(note718), p.352; Hockley, op.cit.(note315), p.179; Morris and Warren, op.cit.(note860), pp.32-33; and Lister, op.cit.(note875), pp.141-142

954 Hockley, op.cit.(note315),p.179

955 IFS, op.cit.(note98), p.384

956 McCrossan, op.cit.(note944), p.111

957 Bill Robinson and Graham Stark, "The Tax Treatment of Marriage: What has the Chancellor Really Achieved?", Fiscal Studies, Volume 9, Number 2, May 1988, 52.

4.2 Deadweight loss

The tax unit for the taxation of married couples has a disincentive effect by distorting married couples' decisions on work, saving and investment. This will result in revenue loss, which is deadweight loss.

4.2.1 Distortions in work decisions

Joint taxation creates a disincentive for a wife to take paid employment because her income will be subject to tax at her husband's highest MTR as a result of the aggregation of spouses' income.[958] Consequently, some wives may work less or substitute staying at home for earning outside the home.[959] Slemrod and Bakija support this argument, stating that "nearly all [empirical research] found that female labor-force participation are responsive [to changes in after-tax wages, and therefore to MTRs.]"[960]

Distortion in wives' work decision possibly leads to revenue loss because if there are no earnings arising from paid employment, the government cannot impose income tax on wives. Furthermore, revenue loss can arise from there being no tax imposed on imputed income from housework done by wives who stay at home. According to the Office for National Statistics, "if housework was paid, it would be worth £700 billion to the UK economy."[961] In Thailand, according to the survey by the National Statistical Office, married women spend on average at least 2.6 hours a day doing housework at present. [962]

Under individual taxation, the wife does not start paying tax at her husband's highest MTR. The MTR on the wife's income under individual taxation is therefore lower than that under joint taxation.[963] Thus, many support the argument that individual taxation encourages married women to take paid employment.[964]

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[958] Stotsky, op.cit.(note866), p.6; and Spenser, op.cit.(note891), p.84

[959] Stotsky, op.cit.(note857), p.126; and Tiley, op.cit.(note141), p.155

[960] Slemrod and Bakija, op.cit.(note63), p.106

[961] BBC News "Housework worth 700 billion pounds", on Wednesday, 24 April, 2002, www.bbc.co.uk.

[962] The National Statistical Office, Statistics Newsletter, 13th Year, Number 7, July 2002, 5.

[963] Morris and Warren, op.cit.(note860), p.28

[964] Messere, op.cit.(note240), p.255; Morris and Warren, op.cit.(note860), p.28; Tiley, op.cit.(note141), p.153; and Spenser, op.cit.(note891), p.85

4.2.2 Distortions in saving and investment

Joint taxation may discourage a wife from saving and investing because the wife's investment income will be taxed at her husband's highest MTR as a result of the aggregation of spouses' income. The wife may therefore save and invest less or substitute spending her money now for saving or investing for the future.

Joint taxation may also distort couples' decisions on saving and investment after marriage. Under joint taxation, a married couple pays more tax on their investment income than they would as single adults since the aggregation of spouses' investment income can be raised to higher MTRs. Kay and Sandler assert, "investment income can be aggregated.... married couples with such income are worse off than if they were just living together."[965] When the investment income of married couples is taxed at a higher rate, some married couples may therefore save and invest less. Stotsky asserts, "evidence from both industrialized and developing countries suggests that changes in the [MTRs]...... alter savings and investment behavior."[966]

Under individual taxation, the tax burdens on the investment income of married women or married couples do not increase after marriage because there is no aggregation of spouses' income. Therefore, individual taxation is neutral to married women's or couples' decisions on saving and investment after marriage.

5. Conflict between equity and efficiency, and proposed solutions

5.1 Conflict under joint taxation

As analyzed in previous sections, joint taxation has both positive and negative impacts on equity and efficiency as summarized below.

(1) **Joint taxation achieves equity in the six cases below. It imposes:**

(i) equal taxation between two married couples with both spouses working and with equal incomes;

[965] Kay and Sandler, op.cit.(note872), p.179
[966] Stotsky, op.cit.(note857), p.126

(ii) equal taxes on a one-earner married couple and a two-earner married couple, with equal incomes, where there is no implication of imputed income from housework;

(iii) equal taxes on two married couples with one spouse working and with equal incomes;

(iv) a heavier tax burden on a two-earner married couple than two single persons living separately, with equal incomes;

(v) a heavier tax burden on a one-earner married couple than two single persons living separately, with equal incomes; and

(vi) it encourages the transfer of resources from the rich to the poor.

(2) **Joint taxation violates equity in the six cases below, in that it does not impose:**

(i) unequal taxes on a one-earner married couple and a two-earner married couple, with equal incomes, where there is imputed income from housework;

(ii) a slightly heavier tax burden on a one-earner married couple than two persons living separately, with equal incomes, where the former cannot earn imputed income from housework; and

(iii) equal taxes on an unmarried couple and a married couple, with equal incomes.

It does not differentiate between:

(iv) the taxation of an unmarried couple and that of two persons living separately, with equal incomes;

(v) the taxation of a single person and that of a one-earner married couple, with equal incomes; and

(vi) the taxation of a single person and that of a two-earner married couple, with equal incomes.

(3) **Joint taxation encourages efficiency by minimizing administrative and compliance costs in the four cases below.**

(i) Its rules are uncomplicated to administer.

(ii) It does not place any responsibility on a married woman for dealing with her tax affairs.

(iii) It is convenient to administer in that tax-gatherers deal with only one partner of the married couple.

(iv) It is simple to comply with because only one partner of the married couple is required to deal with tax-gatherers, and one tax return from one couple is required.

(4) **Joint taxation impedes efficiency by not minimizing administrative and compliance costs in the three cases below.**

(i) It gives a married man responsibility for his wife's tax affairs additional to his own tax affairs.

(ii) It is inconvenient to administer in that tax gatherers have to pay attention to each taxpayer's marital status.

(iii) It is cumbersome to comply with, for example, by the lack of independence and privacy for married women in their tax affairs, or the husband's failure to make a tax return because he does not receive full details of the wife's income.

(5) Joint taxation leads to some forms of tax avoidance and evasion, which impedes efficiency and affects redistribution.

(6) Joint taxation impedes efficiency by distorting married women's or married couples' decisions on work, saving and investment.

From the above, joint taxation achieves equity as summarized in (1), but impedes efficiency as summarized in (4) and (6). Therefore, there is a conflict between equity and efficiency. Legal solutions to this conflict will be discussed in 5.3.1. Furthermore, legal solutions to the violation of equity as summarized in (2) will be explored in 5.3.1.4. Moreover, legal solutions to prevent tax avoidance and evasion as summarized in (5) will be discussed in 5.4.2.

5.2 Conflict under individual taxation

As analyzed in previous sections, individual taxation has both positive and negative impacts on equity and efficiency as summarized below.

(1) **Individual taxation achieves equity in the five cases below. It imposes:**

(i) unequal taxes on a one-earner married couple and a two-earner married couple, with equal incomes, where there is imputed income from housework;

(ii) equal taxes on two married couples with one spouse working and with equal incomes;

(iii) a heavier tax burden on a one-earner married couple than two persons living separately, with equal incomes;

(iv) equal taxes on an unmarried couple and a married couple, with equal incomes; and

(v) a heavier tax burden on a single person than a two-earner married couple, with equal incomes.

(2) **Individual taxation violates equity in the seven cases below**.

(i) It does not achieve:

(a) equal taxation of two married couples with both spouses working and with equal incomes, where the distribution of income between couples is different, and

(b) equal taxation of a one-earner married couple and a two-earner married couple, with equal incomes, where there is no implication of imputed income from housework.

(ii) It does not impose a heavier tax burden on a two-earner married couple than two persons living separately, with equal incomes.

(iii) It may not impose a slightly heavier tax burden on a one-earner married couple than on two persons living separately, with equal incomes, where the former cannot earn imputed income from housework.

(iv) It does not differentiate between the taxation of an unmarried couple and that of two persons living separately, with equal incomes.

(v) It does not differentiate between the taxation of a single person and that of a one-earner married couple, with equal incomes.

(vi) It is not helpful to the transfer of resources from the rich to the poor.

(3) **Individual taxation encourages efficiency by minimizing administrative and compliance costs in the four cases below.**

(i) Its rules are simpler to administer now than rules pre 1990.

(ii) It helps each spouse to understand easily and comply.

(iii) It is convenient to administer, in that tax-gatherers need not keep track of each taxpayer's marital status.

(iv) It is convenient to comply with because married women are given as much privacy and independence in their tax affairs as their husbands.

(4) Individual taxation encourages efficiency because it is neutral to married women's or married couples' decisions to work, save and invest.

(5) Individual taxation leads to tax avoidance by the transfer of investment income between spouses, which impedes efficiency and affects redistribution.

From the above, individual taxation encourages efficiency as summarized in (3) and (4), but violates equity as summarized in (2). Therefore, there is a conflict between equity and efficiency. Legal solutions to this conflict will be discussed in 5.3.2. Furthermore, legal solutions to prevent tax avoidance and evasion as summarized in (5) will be discussed in 5.4.1.

5.3 Proposed solutions (optimal tax unit)

Joint taxation achieves equity, leading to redistribution rather than bringing about efficiency. Conversely, individual taxation encourages efficiency rather than achieving equity and redistribution. To reduce the conflict, the assumption is that laws on the taxation of spouses should incorporate the basic concepts of both joint and individual taxation. However, the question arises as to how these concepts should be integrated.

5.3.1 Solutions to the conflict under joint taxation

Some concepts of individual taxation have been adapted to Thai law in addition to the joint approach, i.e.

(a) Section 57 ter dealing with separate assessment; and

(b) Section 57 quinque dealing with the wife's election for separate taxation of her employment income.

5.3.1.1 Rules of separate assessment

Section 57 ter, Paragraph Two, provides that:

"The husband or wife who wishes to file a separate return may do so by giving notice to that effect to the assessment officer within the time limit for filing returns; provided that such separate filing shall in no way affect the total amount of tax payable."

Section 57 ter, Paragraph Three, provides that:

"The assessment officer may at his discretion divide the tax in proportion to the respective amounts of the assessment income obtained by the husband and wife and notify each of them to pay tax separately."

The above provisions are similar to those under previous UK law. Before the introduction of individual taxation, Sections 283-286 of the TA 1988 dealt with separate assessment. The UK separate assessment was recognized to give a married couple independence and privacy in dealing with their tax affairs.[967] However, it was criticized for being complicated and expensive to administer, and not widely adopted.[968] This implies that separate assessment under previous UK law could not satisfy the efficiency requirement.

In examining whether separate assessment under Thai law can reduce the conflict between equity and efficiency, there are two points to be considered: -

(1) whether joint taxation can still satisfy the equity requirement, and

(2) whether separate assessment can lead to greater efficiency.

Joint taxation can still achieve equity under separate assessment because separate assessment does not affect the total amount of tax payable by a married couple. However, Teeratayakeenun argues that a separate return under Section 57 ter will affect the total amount of tax that the couple must pay.[969] In his view, a separate return can reduce the tax liability of a husband and wife because there is no combined income of spouses.[970] In this regard, he construes Paragraph Two of Section 57 ter regardless of Paragraph Three.[971]

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[967] McCrossan, op.cit.(note944), p.110

[968] ibid.p.110

[969] Teeratayakeenun, op.cit.(note476), p.119

[970] ibid.p.119

[971] In other words, he construes a separate return under Paragraph Two as one resulting from the individual-taxation system.

In my opinion, a separate return under Section 57 ter is separate only in terms of separate assessment. It is not a separate return under individual taxation. In construing the rules of separate assessment, Paragraphs Two and Three must be read and construed together.[972] When they are read and construed together, the following outcomes will apply.

(a) A separate return under Paragraph Two can work only when the assessment officer approves and makes separate assessment under Paragraph Three.

(b) In making separate assessment, the assessment officer will first calculate the married couple's tax bill in the same way as a joint return, namely

  (i) the incomes of both spouses are aggregated to calculate the total amount of tax payable by a married couple,

  (ii) the total tax will subsequently be divided up in proportion to the married couple's respective incomes.

  After receiving notification of the assessment officer, each of spouses will file a separate return and pay tax separately in proportion to his/her income.

(c) Consequently, a separate return does not affect the total amount of tax that the couple must pay.

It has also been found that separate assessment can promote efficiency in the following ways:

Firstly, it gives each spouse independence and privacy in dealing with their tax affairs.[973]

Secondly, a married man does not take responsibility for his wife's tax affairs under separate assessment.[974]

Thirdly, tax-gatherers may not need to pay attention to taxpayers' marital status at all times, because taxpayers disclose their marital status by applying for separate assessment.

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[972] Paragraphs Two and Three cannot be read and construed separately.
[973] Sandford, op.cit.(note195), p.58
[974] Peter G. Whiteman et al., British Tax Library: Whiteman on Income Tax, 3rd ed. (London: Sweet & Maxwell, 1988), 1262.

However, separate assessment depends on the discretion of the assessment officer. This condition may impede the achievement of efficiency, particularly where some assessment officers are reluctant to implement it.[975]

Altogether, separate assessment under Thai law cannot completely eliminate the conflict between equity and efficiency because of the condition mentioned above. The following measures are therefore recommended.

Firstly, separate assessment should be retained in Thai law without the condition mentioned above.

Secondly, Paragraphs Two and Three of Section 57 ter should be combined and amended to read as follows:

> "The husband or wife who wishes to file a separate return may do so by giving notice to that effect to the assessment officer within the time limit for filing returns; provided that such separate filing shall in no way affect the total amount of tax payable. The assessment officer, after receiving such notice, will have to estimate the total amount of tax payable by the husband and wife and then divide the tax in proportion to the respective amounts of assessment income obtained by the husband and wife and notify each of them to file a separate return and pay tax separately."

Thirdly, tax-gatherers may make delegated legislation on technical rules regarding methods, guidelines or directions for supplementing the operation of separate assessment under Section 57 ter. The amended Section 57 ter (as proposed above) and delegated legislation are likely to solve the problem of how to construe rules of separate assessment.[976]

Finally, tax-gatherers should publicize the system of separate assessment. This idea arises from the criticism of separate assessment under previous UK law by Lister. She complains that few married women opted for separate assessment because of "the lack of publicity for separate assessment."[977]

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[975] Lister, op.cit.(note875), p.136

[976] On this basis, separate assessment under the proposal is likely to be less cumbersome and complex to administer and to be widely adopted by married couples.

[977] Lister, op.cit.(note875), p.136

5.3.1.2 Rules of wife's election for separate taxation of employment income

Section 57 quinque, Paragraph One, provides that:

"If a wife had assessable income under Section 40 (1) [employment income] during the tax year, whether with or without any other assessable income, she may file a return and pay tax separately from the husband only in respect of the assessable income under Section 40 (1) [employment income], in which case such assessable income shall not be treated as income of the husband in accordance with Section 57 ter."

The rules of the wife's election for separate taxation under Thai law ("the rules of wife's election") are similar to those under previous UK law. Before the introduction of individual taxation, Sections 287-288 of the TA 1988 dealt with election for the separate taxation of wife's earnings ("the wife's earned income election.")[978] The similarity is that when the wife's election takes place, there will be the following results: -

(a) the wife's earnings (under previous UK law) or the wife's employment income (under Thai law) will be taxed as if the wife were a single woman with no other income; and
(b) the husband's other income will be taxed as if the wife's earnings (under previous UK tax law) or the wife's employment income (under Thai law) were nil.[979]

There are however two dissimilarities between the rules under Thai law and previous UK law.

Firstly, the wife's earnings under previous UK law cover more income than the wife's employment income under Thai law. The wife's earnings include income from an employment, trade, profession and vocation.[980] Meanwhile, the wife's employment income under Thai law is income under Section 40 (1) of the RCT, excluding income from business, commerce, or professions, and any investment income.

Secondly, under previous UK law, both husband and wife had to agree jointly to opt for the separate taxation of wife's earnings. However, under Thai law, a wife

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[978] ibid.p.136
[979] Section 287(3), TA 1988; and Section 57 quinque, RCT.

can elect to be taxed separately on her employment income without her husband's permission.

The wife's earned income election under previous UK law was recognized as leading to efficiency of taxation because it provided an incentive for married women to enter the labor force and discouraged tax evasion and avoidance.[981]

In examining whether the rules of wife's election under Thai law can reduce the conflict between equity and efficiency, the following questions will be examined:

(1) whether joint taxation can still satisfy the equity requirement, and

(2) whether the rules of wife's election for separate taxation can lead to greater efficiency.

Joint taxation cannot achieve equity under the rules of wife's election for two reasons.

Firstly, with equal taxable incomes, a couple in which the wife has employment income will pay less tax than another couple in which the wife has income from other sources than employment. This brings about horizontal inequity. Example 4.22 in **Appendix XII to Chapter Four** helps clarify this point.

Secondly, the rules of wife's election widen the gap between high-income and low-income married couples. This is because the rules do not bring spouses' combined incomes into higher MTRs. Consequently, the rules considerably reduce the tax liabilities of high-income spouses whose combined incomes fall within high MTRs. The UK experience supports this point. According to Tiley, the wife's earned income election benefited those "whose combined incomes took them significantly into higher rate liability."[982]

It has also been found that the rules of wife's election can encourage efficiency, but only in certain ways.

Firstly, the rules give wives independence and privacy in tax matters concerning their employment income. However, the wife's other incomes are still combined with the husband's income for income tax purposes. Therefore, the rules cannot completely solve the problem in joint taxation of its inconvenience, as discussed in 4.1.1.

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[980] Section 287(2), TA 1988

[981] Sandford, op.cit.(note30), p.58

Secondly, although the husband does not take responsibility for his wife's tax matters concerning employment income, he still has to take responsibility for his wife's other incomes. Therefore, the rules cannot completely solve the problem of married men in complying with joint taxation, as discussed in 4.1.1.

Thirdly, the rules of wife's election provide incentives for wives to take paid employment. This is because the wife's employment income is not aggregated with the husband's for income tax purposes. From the UK experience, the wife's earnings election has been introduced to provide an incentive to work.[983]

However, since the wife's other incomes are still combined with the husband's income, the rules of wife's election under Thai law do not provide incentives for married women to save, invest or produce income other than employment income. Therefore, the rules cannot completely reduce the disincentive effect, as discussed in 4.2.2.

Finally, the rules of wife's election may reduce incentives for some married couples to avoid or evade tax because some married couples pay less tax under such rules than they would under the basic rules of joint taxation. From the UK experience, earning couples tend to evade and avoid tax when the highest MTR exceeds 70%. The wife's earnings election has been introduced to discourage tax avoidance and evasion.[984]

Furthermore, the rules of wife's election help joint taxation to prevent tax avoidance by inter-spousal transfer of investment income. This is because even if such transfer occurs, the wife's investment income continues to be combined with the husband's income for income tax purposes. In this regard, some analysts agree that the joint approach should apply to investment income. For example, Messere notes, "most countries with separate taxation for earned income required joint taxation for dividend and interest income to prevent tax avoidance by couples artificially splitting their investment income."[985] In the UK, Morris and Warren propose separate taxation for earned income and joint taxation for investment

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[982] Tiley, op.cit.(note131), p.150
[983] Sandford, op.cit.(note195), p.58
[984] ibid. p.58
[985] Messere, op.cit.(note936), p.12

income.[986] They claim that "to avoid the need for inter-spousal transfers, the couple should be the unit for investment income which should be aggregated."[987]

Altogether, the rules of wife's election under Thai law undermine equity and impede redistribution. Also, they cannot completely fulfil the efficiency requirement.

5.3.1.3 Suggestions for reducing the conflict under joint taxation

As analyzed earlier, the basic rules of joint taxation can achieve equity but impede efficiency in some respects. Measures for increasing efficiency and sustaining equity should therefore be introduced to reduce the conflict between equity and efficiency. Four measures for achieving this purpose are recommended below.

The first measure deals with revision of the basic rules in Paragraph One of Section 57 ter. This section presently provides that:

> "For the purpose of charging income tax on a husband and wife, the assessable income of the wife shall be treated as the income of the husband, if they have lived together throughout the tax year. In this regard, the husband shall have the duty and liability to file a return and pay tax; provided that if the tax falls in arrears and the wife has received a prior notice of not less than seven days, the wife shall be jointly liable to settle the arrears."

I propose to revise the above provision to read:

> "For the purpose of charging income tax on a husband and wife, the husband and wife shall be taxed on their joint assessable income if they have lived together throughout the tax year. In this regard, the husband and wife shall both have the duty and liability to file a return and pay tax."

Like Thai law, previous UK tax law was based on the joint-taxation system, under which married women were considered to be receiving unequal treatment. And, as noted earlier, the joint-taxation system was much criticized in the UK. One criticism is referred to in Morris and Warren:

> "What is it about the [the joint-taxation system] which has drawn so much criticism? Perhaps the main feeling is that a tax system which treats the wife merely as her husband's chattel is out-of-date; but it is not relevant today

[986] Morris and Warren, op.cit.(note860), p.28
[987] ibid.p.46

when many wives are equal partners in providing the income to support the family. The removal of this problem alone is simple – to make the couple jointly responsible for tax rather than the husband. This could be done by rewording the income tax acts to make the couple jointly liable for their tax while leaving their overall tax liability unchanged."[988]

In my view, the combined income of both spouses under joint taxation has the merits of equity and efficiency in certain respects. Although the unfair treatment of wives devalues the system, the system should not be removed as a whole. Conversely, the problem of gender inequality should be resolved; meanwhile, the basic concept of the combination of both spouses' incomes should be retained. The basic rules in Paragraph One of Section 57 ter should therefore be revised, according to my proposed revision above, to make the husband and wife jointly responsible and liable for their taxes.

The proposed revision will not affect the operation of joint taxation but remove the problem of gender inequality in the tax system. The problem is solved because a wife would enjoy an equal right with her husband to deal with their joint tax affairs. This will correspond with the provision of the CCCT relating to the management of the major assets of married couples, which requires both spouses to manage jointly the major assets derived from marriage.[989] The tax payment concerns money matters, which is as important as the management of the spouses' major assets; therefore the spouses should jointly look after their tax affairs.

In terms of increasing efficiency, the proposed revision will solve the problem of the inconvenience of joint taxation, as discussed in 4.1.1. Joint taxation may cause certain inconveniences for some married couples because:

(a) the men may not be responsible for their wives' tax affairs, and

(b) the women may not tell their husbands the full details of their income.

The duty and liability of spouses jointly to file a return and pay tax, as proposed above, may solve these problems.

Besides, the joint duty and liability of spouses will reduce the responsibility of some husbands for their wives' tax affairs, which will solve the problem for

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[988] Morris and Warren, op.cit.(note860), p.29
[989] Section 1476, CCCT

husbands of complying with the rules of joint taxation. Furthermore, such joint duty and liability will not need the proviso on the wife's liability for arrears. This will be convenient for tax-gatherers to administer. Moreover, the proposed revision will still help prevent tax avoidance by the inter-spousal transfer of investment income.

The second measure is that the rules of separate assessment under Paragraph Two and Paragraph Three of Section 57 ter should be retained; provided that there is an amendment to this section as proposed in 5.3.1.1.

The third measure involves the abolition of the rules of wife's election for separate taxation under Section 57 quinque. This is because the rules undermine equity, impede redistribution and cannot completely fulfil the efficiency requirement, as analyzed in 5.3.1.2. If Section 57 quinque were abolished as proposed, joint taxation would continue to operate under (a) the revised basic rules in Paragraph One of Section 57 ter, and (b) the revised rules of separate assessment in Paragraph Two and Paragraph Three of Section 57 ter.

The fourth measure concerns a reduction in a disincentive effect. Low MTRs, few and wide tax bands, can reduce distortion in married couples' economic decisions. This is because the combined incomes of some married couples may not be lifted to higher tax bands. If the combined incomes of other married couples are still pushed into higher tax bands, they will face a lower number of tax bands with lower MTRs. As also discussed in subsection 3.2.1, the tax-rate schedule which designed to contain low MTRs, few and wide tax bands helps joint taxation to achieve equity by imposing lower tax burdens on most married couples, particularly on low-income and (lower) middle-income married couples. Therefore, these features of the tax-rate schedule will promote both equity and efficiency.

5.3.1.4 Solutions to other violations of equity arising from joint taxation

Even though joint taxation may achieve equity in some cases, it violates equity in six other cases, as summarized in 5.1 (2). Inequities arising from such cases should therefore be lessened.

Case one

As analyzed in 3.1.2, a one-earner married couple may be believed to have a greater taxable capacity and be liable for higher tax than a two-earner married couple, with equal incomes. However, under joint taxation, a one-earner couple does not pay more but pays the same tax as a two-earner couple. This inequity would be lessened if imputed income were taxed. However, imputed income is non-measurable for taxation; consequently, this inequity still exists under joint taxation.

Case two

As analyzed in 3.1.6, a cohabiting couple has the same taxable capacity as a married couple, with equal incomes. The former must pay the same tax as the latter. However, under joint taxation, the former pays less tax than the latter. This inequity would be lessened if cohabitation could be monitored. However, tax-gatherers cannot monitor cohabitation for taxation; consequently, this inequity still exists under joint taxation.

Case three

As analyzed in 3.1.7, a cohabiting couple has a greater taxable capacity and must pay more tax than two single persons living separately, with equal incomes. However, under joint taxation, the former does not pay more but pays the same tax as the latter. This inequity would be lessened if cohabitation could be monitored.

Case four

As analyzed in 3.1.8, a single person has a greater taxable capacity and must pay more tax than a one-earner married couple, with equal incomes. However, under joint taxation, the former does not pay more but pays the same tax as the latter. Reduction of this inequity can be achieved through tax reliefs.

Each Thai taxpayer is entitled to the basic personal allowance. If a Thai taxpayer has a spouse who does not have any assessable income, the taxpayer also claims an allowance for the spouse additional to the basic allowance. This means that a one-earner married couple has two allowances, while a single person receives one allowance. Consequently, entitlement to two allowances is likely to help a one-earner married couple to pay less tax than a single person, with equal incomes.

Case five

As analyzed in 3.1.9, a single person has a greater taxable capacity and must pay more tax than a two-earner married couple. However, under joint taxation, the former does not pay more but pays the same tax as the latter. Reduction of this inequity can be achieved through tax reliefs.

Under Thai law, where both husband and wife have assessable income, they are entitled to two basic allowances.[990] Meanwhile, a single person receives one basic allowance. Consequently, a two-earner married couple pays less tax than a single person, with equal incomes. Entitlement to two allowances for a two-earner married couple helps lessen inequity.

Case six

In footnote 919, it was noted that a one-earner married couple may have a slightly greater taxable capacity than two persons living separately, with equal incomes. This is because a non-earning spouse of the former may be too old or unhealthy to do housework. In this case, the former should then have a slightly heavier tax burden imposed than the latter.

As discussed in Case four, each taxpayer can claim the basic allowance. Two persons living separately therefore receive two basic allowances. Meanwhile, a married couple with one spouse earning outside and another staying at home is also entitled to two allowances (the basic allowance and an allowance for the taxpayer's spouse.) As a result of equal allowances, a one-earner married couple may pay a slightly higher tax than two single persons living separately. Conversely, if a one-earner married couple receives only one allowance, this couple could pay a much higher tax than two persons living separately.

Although an allowance for the taxpayer's spouse who stays at home may help reduce inequity, it may create a disincentive for a non-earning spouse to work outside the home. The following measures are therefore recommended.

Firstly, an allowance for the taxpayer's spouse should be given to a married person whose spouse stays at home because he/she cannot find out a job and to a married person whose spouse stays at home but cannot do housework because of old age, poor health, illness, disability, or the need to spend time caring for his/her parents or relatives who cannot look after themselves.

Secondly, an allowance for the taxpayer's spouse should not be given to a married person whose healthy spouse chooses not to earn outside but to stay at home whether to enjoy leisure or do housework. The reason is that imputed income from

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[990] Section 47 (2), RCT

housework is non-taxable, and such an allowance (if given) would discourage a non-earning spouse from labor participation, resulting in inefficiency of taxation.

5.3.2 Solutions to the conflict under individual taxation

As analyzed earlier, individual taxation promotes efficiency rather than equity. To strike the right balance between them, methods that reduce inequity and maintain efficiency must be established.

5.3.2.1 Proposed integration of joint taxation with individual taxation, and rules to prevent inter-spousal transfer

As analyzed in 3.2.2, the taxation of spouses' separate income may help wealthy married couples to reduce their tax liabilities by transfers of investment income between spouses. Inter-spousal transfer may therefore undermine equity. This leads to conflict between equity and efficiency.

To prevent inter-spousal transfer, joint taxation has sometimes been proposed to apply to investment income, while individual taxation is applied to earnings.[991] Nevertheless, the proposed integration of joint taxation with individual taxation has not been brought into the UK tax law. The possible reason for this is that "most organizations favour disaggregation of investment income, and its treatment on an individual basis."[992]

Rules to prevent the inter-spousal transfers of investment income are another alternative. However, Morris and Warren disagree about such rules[993] arguing that such prevention requires complex rules, leading to high administrative costs.[994]

The question arises whether (1) the integration of joint taxation for investment income with individual taxation for earnings or (2) rules to prevent inter-spousal transfer is the better method to create a more equitable redistribution of income while maintaining efficiency under individual taxation. It is found that the first method cannot achieve both equity and efficiency at the same time for the following reasons.

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991 Kay and Sandler, op.cit.(note872), p.184
992 ibid.p.179
993 Morris and Warren, op.cit.(note872), p.32
994 ibid.p.40

The first reason concerns violation of equity. Where two married couples have equal taxable income, a couple with earned income will pay less tax than another couple with investment income. This is because:

(a) the former is taxed on their separate incomes, while the latter is taxed on their joint incomes; and

(b) as a result of the progressive rate structure, tax burdens will fall more heavily upon the latter than upon the former.

The second reason involves efficiency of taxation. The integration of joint with individual taxation may encourage efficiency because it may:

(a) prevent inter-spousal transfer of investment income; and

(b) reduce incentives for some married couples to avoid or evade tax on their earned income because they will pay less tax than they would under the pure form of joint taxation.

However, the integration of joint taxation with individual taxation may impede efficiency because it may **not**:

(a) create incentives for some married women to save and invest even if it creates incentives for other married women to enter the labor force;

(b) give some married women independence and privacy in tax matters regarding their investment income even if it gives other married women independence and privacy in tax matters regarding their earned income;

(c) reduce the greater responsibilities of some married men in dealing with their wives' tax matters regarding investment income even if it does not put greater responsibilities on other married men in dealing with their wives' tax matters regarding earned income.

Rules to prevent inter-spousal transfer are likely to be a better method of creating a more equitable redistribution of income while maintaining efficiency under individual taxation. This is because in addition to undermining equity, inter-spousal transfer affects administrative and compliance costs. Therefore, if rules to prevent inter-spousal transfer work effectively, they will achieve both equity and efficiency. However, such anti-avoidance rules will achieve this objective if they are not too complex to administer and to comply with. Anti-avoidance rules will be further discussed in 5.4.1.

5.3.2.2 Abolition of married couple's allowance in the UK

As analyzed in 3.1.4, if two individual taxpayers have the same income before and after marriage, they have a greater taxable capacity and should therefore pay higher tax after marriage. However, under individual taxation, the spouses pay the same tax as they would if they were single adults. Furthermore, since wealthy couples do not pay higher tax after marriage, this also affects equity. Such inequities lead to conflict between equity and efficiency. Reducing these inequities will reduce the conflict.

There is no effective method completely to resolve the above conflict. However, it can be lessened through the abolition of the married couple's allowance. Under individual taxation, each spouse is entitled to the basic personal allowance that can reduce his/her taxable income and tax liability in the same way as other single taxpayers. Additionally, in the years before 2000-2001, a married couple who lived together was entitled to a married couple's allowance ("the MCA").

From April 1994, the MCA was given as a reduction in the tax bill at the fixed rate of the amount of the allowance. The MCA was therefore a tax credit or a tax reducer.[995] The MCA was calculated as 20% of the amount of the allowance for 1994-1995, as 15% for 1995-1999, and as 10% for 1999-2000.[996]

The MCA could only be claimed by married couples, not by single people. Consequently, the tax liabilities of married couples were further reduced below those of single people. Such reductions increased inequity. Robinson and Stark support the view that "the favourable treatment of childless two-earner couples [with the MCA] relative to two single people living apart is manifest injustice."[997] Furthermore, as Sandford notes, "to have a system of independent taxation but a married couple's allowance was an anomaly."[998]

Moreover, the MCA did not help boost redistribution from the rich to the poor because wealthy couples not just those on low incomes benefited from the MCA. However, the MCA encouraged redistribution from the single, widowed, and divorced to married couples.[999]

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[995] Inland Revenue, Tax Allowances and Reliefs, http://www.inlandrevenue.gov.uk/pdfs/ir90.htm, 3.
[996] Inland Revenue, Tax Structure and Parameters, http://www.inlandrevenue.gov.uk/stats/tax_struc…/00ap_a1c_2.ht, 1.
[997] Robinson and Stark, op.cit.(note957), p.56
[998] Sandford, op.cit.(note195), p.61
[999] Kay and King, op.cit.(note60), p.44

It is clear that the MCA increased the inequity of income redistribution. The MCA also affected efficiency of taxation because it constituted substantial tax expenditure.[1000] The MCA was abolished in April 2000.[1001] However, the MCA is still available for pensioner couples.[1002] This may be reasonable because elderly couples have less taxable capacities.

The abolition of the MCA has lessened inequity and increased efficiency. HM Treasury estimates that "the full yield from abolition for all married couples would be 2.5 billion pounds in 2001-02."[1003] The abolition of the MCA therefore helps lessen the conflict between equity and efficiency under individual taxation.

5.3.2.3 Reduction in the conflict caused by different treatment of one-earner and two-earner married couples

As analyzed in 3.1.2, a one-earner married couple may have the same taxable capacity as a two-earner married couple, with equal incomes. This would arise when a non-earning spouse of the former could not do housework because of old age or poor health; consequently, both couples would pay for the same household services. However, under individual taxation, a one-earner couple pays more tax than a two-earner couple with equal incomes. Individual taxation thus violates equity, leading to conflict between equity and efficiency.

To reduce the inequity and conflict, the tax liability of a one-earner couple should be reduced through tax reliefs. It is found that up to 5 April 2000, "a married person whose spouse was unable to look after himself or herself at all, for the whole tax year, because of illness or disability", could claim the additional personal allowance.[1004] This allowance is given as a reduction in tax at a fixed rate in the same

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[1000] Robinson and Stark, op.cit.(note957), p.56

[1001] Section 31, the Finance Act 1999

[1002] The MCA is still available for married couples where one of the spouses was born before 6April 1935 and whose ages are 75 or above. In 2004/05, the MCA reduces a taxpayer's tax bill by £572.50 (10% of £5725) for those aged under 75 and born before 6 April 1935 and by £579.50 (10% of £5795) for those aged 75 or above. However, the amounts of the MCA (£5725and£5795) are reduced by £1 for every £2 of income above the income limit (18,900). However, they cannot be reduced below the minimum amount of £2210.

[1003] HM Treasury, Financial Statement and Budget Report March 1999: 1 Budget Measures, http://archive.treasury.gov.uk/budget/1999/fsbr/29807.htm, 31.

[1004] Inland Revenue, op.cit.(note995), p.3

way as the MCA.[1005] However, this allowance was available only to a married person who had a qualifying child.[1006] It was abolished in April 2000.[1007]

The above additional personal allowance could reduce the tax liability of a married person whose spouse cannot look after himself/herself. This allowance helped reduce inequity arising from the different treatment of a one-earner couple and a two-earner couple with equal incomes. Nevertheless, this allowance only benefited a one-earner married couple who had a qualifying child. Although this additional personal allowance was abolished, a one-earner married couple is now eligible for the CTC if they have at least one child.

By contrast, a childless married person whose spouse cannot do housework because of illness or disability could not claim the additional personal allowance, and cannot claim the CTC in the present system. Consequently, there is still inequity arising from the different treatment of a one-earner couple and a two-earner couple, with equal incomes. The following proposals are therefore put forward.

Firstly, an additional personal allowance should be available to a childless married person whose spouse stays at home but cannot do housework or look after himself/herself because of old age, poor health, illness, disability, or the need to spend time caring for parents or relatives who cannot look after themselves. According to Kay and Sandler, the tax and benefit system should provide for allowances to "people who look after elderly relatives, the blind, the disabled, and so on."[1008]

The proposed additional allowance should be given as a reduction of taxable income. However, to enhance redistribution, the proposed allowance should not be available to a one-earner childless couple with a high income.

Secondly, the law should not give an additional personal allowance to a childless married person whose spouse chooses not to work but to stay at home. Spencer puts forwards the idea that "[the] individual system may give one spouse allowance for a non-earning spouse."[1009] Morris and Warren disagree that the state

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1005 ibid.p.4
For example, this allowance reduced a taxpayer's tax bill by up to a set amount of £197 in 1999.
1006 ibid.p.3
1007 Section 33, the Finance Act 1999
1008 Kay and Sandler, op.cit.(note872), p.183
1009 Spencer, op.cit.(note891), p.89

has no duty to give tax advantages to wives who choose to stay at home.[1010] I agree with Morris and Warren. This is because if such an allowance were available, it would discourage a non-earning spouse from going out to work, which might result in inefficiency of taxation. Robinson and Stark support the view that the role of the tax system in redistributing income and providing incentives to work is bound up with the size of allowances.[1011]

5.3.2.4 Reduction in the conflict caused by different treatment of a one-earner married couple and two single persons living separately

In footnote 919, a one-earner married couple may have a slightly greater taxable capacity than two single persons living separately, with equal incomes. The former should therefore pay a slightly higher tax than the latter. Under individual taxation, a one-earner couple will not pay a slightly higher tax (but may pay a much higher tax) than two persons living separately. Individual taxation therefore violates equity, leading to conflict between equity and efficiency.

To reduce the above inequity and conflict, the tax liability of a one-earner couple should be reduced through tax reliefs. The law should allow an additional personal allowance to be available to a childless married person[1012] whose spouse stays at home but cannot do housework because of old age, poor health, illness, disability or time spent caring for parents or relatives. The proposed allowance should be given as a reduction of taxable income.

However, the proposed allowance should not be available to a childless married person whose healthy spouse chooses not to earn outside but to stay at home whether to enjoy leisure or do housework. This is because (a) imputed income from housework is non-taxable, and (b) as discussed in Sub-section 5.3.2.3, if the proposed allowance were available to such a childless married person, it would discourage a non-earning spouse from going out to work.

[1010] Morris and Warren, op.cit.(note860), p.46

[1011] Robinson and Stark, op.cit.(note957), p.52

[1012] A one-earner married couple with dependent children is now eligible for the CTC. Therefore, the proposed additional personal allowance should not be available to them.

5.3.2.5 Reduction in the conflict caused by different treatment of a single person and a one-earner married couple

As analyzed in 3.1.8, a single person has a greater taxable capacity and should pay more tax than a one-earner married couple, with equal incomes. However, under individual taxation, the former does not pay more but pays the same tax as the latter. Individual taxation therefore violates equity, leading to conflict between equity and efficiency.

To reduce the above inequity and conflict, the tax liability of a one-earner couple should be lower than that of a single person through tax reliefs. I would recommend that proposals made in 5.3.2.4 (i.e. the introduction of an additional personal allowance available to a one-earner couple with childless) should apply to reduce inequity in this case.

5.3.2.6 Reduction in the conflict caused by different treatment of two-earner married couples

As analyzed in 3.1.1, two-earner married couples with equal incomes have equal taxable capacity and should pay equal taxes. However, under individual taxation, a couple where both spouses earn income equally pays less tax than a couple where both spouses earn income unequally. Individual taxation thus violates equity, leading to conflict between equity and efficiency.

To reduce the above inequity and conflict, all two-earner married couples with equal incomes should pay equal taxes. A reduction in this inequity cannot be achieved through tax reliefs because two-earner couples can claim the same personal allowances. Therefore, a reduction in this inequity should be made through the progressive rate structure.

It has been found that changes in the tax-rate schedule under the present UK tax-rate schedule by reducing tax rates and tax bands as well as widening tax bands help reduce the likelihood of different treatment of low-income couples where the distribution of income between couples is different. However, these features of the tax-rate schedule are unlikely to reduce the different treatment of two high-income couples where the distribution of income between both couples is different. Example

4.23 and Example 4.24 in **Appendix XIII to Chapter Four** will elucidate these points.

Therefore, the present UK tax-rate schedule (2004-05) which contains few tax rates and bands as well as wide tax bands cannot completely resolve the problem of different treatment of married couples with equal incomes. Nevertheless, these features of the tax rate structure possibly reduce inequity in taxing low-income couples. Meanwhile, they maintain efficiency of taxation because they still create incentives to work and discourage tax avoidance and evasion.

It has been found that if the proposed two tax-rate schedules (as discussed in Chapter Two) were put into practice, they would reduce the different treatment of two low-income married couples where the distribution of income between both couples is different. Additionally, the proposed two tax-rate schedules would reduce the different treatment of two high-income couples where the distribution of income between both couples is different. Example 4.23 and Example 4.24 in **Appendix XIII to Chapter Four** will elucidate these points. Therefore, the proposed two tax-rate schedules would possibly reduce inequity in taxing low- and high-income married couples under individual taxation.

5.3.2.7 Reduction in the conflict caused by the same treatment of an unmarried couple and two persons living separately

As analyzed in 3.1.7, a cohabiting couple has a greater taxable capacity and must pay more tax than two single persons living separately, with equal incomes. However, under individual taxation, the former does not pay more but pays the same tax as the latter. Individual taxation thus violates equity, leading to conflict between equity and efficiency.

To reduce the above inequity and conflict, a cohabiting couple must pay more tax than two persons living separately. However, this cannot be achieved through tax reliefs because both groups of taxpayer are entitled to the same personal allowances. Additionally, a reduction in this inequity cannot be made through changes in the progressive rate structure because they are subject to the same tax rates. Therefore, the tax law should not provide any additional tax reliefs for cohabitees other than personal allowances since such reliefs would increase inequity.

5.4 Measures to prevent tax avoidance schemes

In this section, measures to prevent avoidance schemes under individual taxation will first be examined, the ideas of which will be helpful to analyze measures under joint taxation thereafter.

5.4.1 Prevention of tax avoidance under individual taxation

Inter-spousal transfer for tax avoidance affects equity for two reasons. Firstly, income will be redistributed from married couples who do not make the transfer to those who make the transfer. Wealthy couples are in a better position to make the transfer. A reduction in the tax liabilities of wealthy couples through inter-spousal transfer enhances inequity. Secondly, income will be redistributed from a single person (who cannot transfer his/her income-producing property to his/her spouse) to a married couple who can make the transfer.[1013]

Inter-spousal transfer for tax avoidance also affects efficiency of taxation for four reasons. Firstly, married couples' rearrangement of assets to reduce tax increases non-compliance costs. Secondly, administrative costs are increased due to the need to administer special rules to prevent inter-spousal transfer. Thirdly, greater compliance and administrative costs would be incurred if anti-avoidance rules were more complex. Finally, there is revenue loss.[1014]

There are five possible measures that help prevent avoidance schemes, i.e.

(a) rules on jointly held property,

(b) rules on settlements and outright gifts,

(c) high rates of divorce,

(d) rules to prevent the shifting of property to children, and

(e) reduction in tax rates.

5.4.1.1 Rules on jointly held property

It is argued that "where a married couple who live together hold investments, bank accounts etc in their joint names it can be hard to decide how to split the income

[1013] Hockly, op.cit.(note315), p.180

[1014] Morris and Warren, op.cit.(note860), pp.32-33; Lister, op.cit.(note875), pp.141-142; and Kay and Sandler, op.cit.(note872), p.180

between them."[1015] However, rules on jointly held property as found in Sections 282A and 282B of the TA1988 can help the Revenue to deal with this problem.

According to the basic rule in Section 282A, each spouse will be taxed on half the income arising from property (other than shares in a close company)[1016] held in the married couple's joint names. However, if the spouses own such property in unequal shares and they make a declaration to this effect to the Revenue, each spouse will be taxed on the portion of the income to which he/she is entitled.[1017] This rule is found in Section 282B. These rules on jointly held property help the Revenue and married couples to decide what amounts are taxable for each spouse.[1018]

When the Civil Partnership Act 2004 (CPA) is enforceable from 5 December 2005, civil partners (same-sex couples) will be treated in the same as (or a similar way to) married couples for tax purposes.[1019] Therefore, rules on jointly held property in Section 282A and 282B will also apply to civil partners from 5 December 2005. On this basis, each partner will be taxed on half the income arising from property (other than shares in a close company) held in the same-sex couple's joint names. However, if a same-sex couple own such property in unequal shares and they make a declaration to this effect to the Revenue, each partner will be taxed on the portion of income to which he/she is entitled. These rules on jointly held property help the Revenue and same-sex couples to decide what amounts are taxable for each partner.

Rules on jointly held property do seem to ease the tasks of the Revenue and of married and same-sex couples to collect and to pay tax on income arising from jointly held property. However, rules on jointly held property hardly help prevent the transfer of the property between spouses or between civil partners to reduce tax. These rules may have incentive effects on the transfer of the property to the married couple's joint names or to the same-sex couple's joint names. Similarly, a married

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[1015] Revenue Internal Guidance-Independent taxation handbook, Simon's Direct Tax Service, Binder 12 (London: Butterworths, 1995), 13111.

[1016] From 6 April 2004, each spouse will not be taxed on half dividends or distributions from jointly owned shares in close or family companies but will be taxed according to the actual ownership. Close companies are "those under the control of five or fewer persons and their associates." (Walter Sinclair, ST.James's Place Tax Guide 2005-2006 (Hampshire: Palgrave Macmillan, 2005), 35 and 168.)

[1017] Inland Revenue's Press Release, Simon's Weekly Tax Service 17th March, Simon's Tax Intelligence (London: Butterworths, 1988), 175.

[1018] Revenue Internal Guidance, op.cit.(note1015), p.13112 couple or a same-sex couple can save tax by transferring the property into the married couple's joint names or to the same-sex couple's joint names. Any kind of property (other than close company shares) such as land and buildings, non-close company shares, bank accounts, etc. can be transferred.[1020] Example 4.25 in **Appendix XIV to Chapter Four** helps elucidate this point.

The inter-spousal transfer of the property to joint ownership will further reduce tax, "where one spouse would be paying a higher rate tax while the other did not fully use the basic rate band."[1021] Example 4.26 in **Appendix XIV to Chapter Four** helps elucidate this point. Also, a partner (within the CPA 2004) paying a higher rate tax will receive income tax savings when he/she transfers the property to joint ownership where his/her partner who does not fully use the basic rate band.

Additionally, the transfer of the property between spouses or between civil partners into joint ownership in which the spouses or the civil partners own unequal shares will further reduce tax. This will work out if-

(a) the husband and wife or the civil partners are subject to different tax rates,
(b) the high-earning spouse or the high-earning partner is willing to make a significant transfer to the low-earning spouse or to the low-earning partner,
(c) the transfer is straightforward or outright, and
(d) both the husband and the wife or both civil partners make a declaration that they own the property in unequal shares.

Example 4.27 in **Appendix XIV to Chapter Four** helps elucidate this point.

From the above, the rules on jointly held property hardly help prevent the transfer of the property between spouses or between civil partners to reduce tax, but may encourage such transfer to reduce tax, provided that such transfer is straightforward or outright, which will be discussed below. It is confirmed that:

> "Where there is a straightforward gift or transfer of asset from the sole ownership of a husband or wife into joint ownership by the couple, the

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[1019] Section 103, Finance Act 2005

[1020] Arnold Homer and Rita Burrows, Tolley's Tax Guide (2004-05) (London: Lexis Nexis UK, 2004), 580.

[1021] Arnold Homer and Rita Burrows, Tolley's Tax Guide (2000-01), 19th ed. (Surrey: Tolley Publishing, 2000), 501.

income from the asset should be divided between the husband and wife in accordance with the normal rules for jointly held property."[1022]

5.4.1.2 Rules on settlements and outright gifts

The above rules help prevent tax avoidance by inter-spousal transfer. The basic rule on settlements in Section 624 (1) of the ITTOIA 2005 says,

"Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone if it arises -

(a) during the life of the settlor, and

(b) from property in which the settlor has an interest."

As for a settlement made by the spouse, Tiley illustrates this as follows:

"Where one spouse has carried out a transaction falling within [the] definition of settlement, and income arises to the other spouse as a result of that transaction, the income is treated as that of the settlor-spouse and not of the other spouse."[1023]

The term "settlement" is defined in Section 620 (1) of the ITTOIA 2005 as including any disposition, trust, covenant, agreement, arrangement or transfer of assets (except that it does not include a charitable loan arrangement). As a result of the settlement rule, the transfer of property from one spouse to the other with a view to reducing tax may be ineffective. This is because (a) the transfer of property is a transaction within the definition of settlement, and (b) income arising from the transferred property is still treated as that of the transferor-spouse and not as that of the transferee-spouse. The settlement rule thus prevents tax avoidance by inter-spousal transfer. Tiley confirms that "this [settlement] rule appears to prevent income-splitting between the spouses by the device of transferring either assets or income between them."[1024]

However, inter-spousal transfer can reduce the tax liability of the transferor-spouse if such transfer is an outright gift between the spouses. Likewise, an outright gift of property between the spouses is treated as outside the settlement rule.[1025] This

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[1022] Revenue Internal Guidance, op.cit.(note1015), pp.13143-13144
[1023] Tiley, op.cit.(note141), p.148
[1024] ibid.p.148
[1025] ibid.p.148

is because income arising from an outright gift of property is treated as that of the spouse who receives the gift (the donee-spouse), and not as that of the spouse who makes the gift (the donor-spouse).[1026] The donee-spouse will then be taxed on the income arising from such gift. This is found in Section 626 (1) (2) (3) of the ITTOIA 2005. However, the donor-spouse will be taxed on income arising from the gift of property if (a) the donor-spouse can still control and retain a benefit in the given property, or (b) the gift is a right to receive income. This is because according to Section 626 (1) (2) (3) of the ITTOIA 2005, it is treated as an outright gifts where "the gift carries a right to the whole of that income", and "the property given is not wholly or substantially a right to income."

Furthermore, if the gift made by one spouse to the other is not an outright gift, income arising from such gift will still be treated as that of the donor-spouse. The donor-spouse will then be taxed on the income arising from such gift. In this regard, Section 626 (4) of the ITTOIA 2005 provides that a gift is not an outright gift if -

"(a) it is subject to conditions, or

(b) there are any circumstances in which the property, or any related property –

(i) is payable to the giver,

(ii) is applicable for the benefit of the giver, or

(iii) will, or may become, so payable or applicable."

Additionally, although an outright gift of property between the spouses is outside the settlement rule, the Revenue consider that in some circumstances a gift of ordinary shares in a family company from one spouse to another is within the settlement rule.[1027] In other words, the donor-spouse will then be taxed on the income arising from such gift. Furthermore, "taking a spouse into partnership, ... with the spouse's share [not] being appropriate to his or her contribution to the business....", will be treated as a settlement, "in which case the income would remain that of the other spouse"[1028]

[1026] Revenue Internal Guidance, op.cit.(note1015), pp.13143-13144; Section 660A(6), TA 1988

[1027] Homer and Burrows, op.cit.(note1020), p.351

[1028] ibid.p.450

However, the Revenue do not regard the inter-spousal transfer of property to joint ownership as joint tenants, as breaching the rule on outright gifts.[1029] 'Joint tenants' means that "each [spouse] has equal rights over the property and when one dies, it goes automatically to the other."[1030]

It is clear that rules on settlements and outright gifts help prevent tax avoidance via inter-spousal transfer. When we apply rules on settlements and outright gifts to civil partners, the transfer of the property between civil partners can reduce the tax liability of a wealthier partner (or a transferor partner) if such transfer is an outright gift between civil partners. However, the donor-partner will be taxed on income arising from the gift of property if (a) the donor-partner can still control and retain a benefit in the given property, (b) the gift is a right to receive income, (c) the gift is subject to conditions, or (d) the gift could revert to the donor-partner in any circumstances whatsoever.

5.4.1.3 High rates of divorce

A change in social patterns regarding divorce may discourage inter-spousal transfer. The divorce rate in Britain is the highest in the European Union.[1031]

The high rates of divorce may affect a high-earning spouse's decision to transfer property to the low-earning spouse to avoid tax. The reason is that if such transfer occurred, "[it] could become permanent and inaccessible on a breakdown in a marriage."[1032] Tax avoidance via inter-spousal transfer is therefore a risky strategy[1033], which wealthy couples may be reluctant to pursue.[1034]

[1029] Homer and Burrows, op.cit.(note1021), p.501
[1030] ibid.p.502
[1031] Anne Barlow, Simon Duncan, Grace James and Alison Park, "Just a piece of paper? Marriage and cohabitation", British Social Attitudes the 18th Report, Alison Park, John Curtice, Katarina Thomson, Lindsey Jarvis and Catherine Bromley, eds., (London: SAGE Publications, 2001), 29.
[1032] McCrossan, op.cit(note944), p.111
[1033] Rosen, op.cit.(note250), p.365
[1034] James, op.cit.(note858), p. 119

5.4.1.4 Rules to prevent the switching of property to children

The transfer of income-producing property to children is another means of tax avoidance. This is because the income of children is their income and taxed separately from that of their parents.[1035]

However, the parental settlement rule in Section 629 (1) of the ITTOIA 2005 helps prevent this form of tax avoidance. This section provides that

> "Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone for a tax year if, in that year and during the life of the settlor, it –
>
> (a) is paid to, or for the benefit of, and unmarried minor child[1036] of the settlor, or
>
> (b) would otherwise be treated (apart from this section) as income of an unmarried minor child of the settlor."

As referred to earlier, a settlement includes any transfer of assets.[1037] This implies that the resulting income from the transfer of property to or for the benefit of an unmarried minor child will be taxed as if it belonged to the parent. Tax avoidance by the transfer of property to unmarried minor children is therefore prevented by this rule. However, this rule does not apply where the gross amount paid to an unmarried minor child under a settlement does not exceed £100 per annum.[1038]

Therefore, the rule in Section 629 (1) of the ITTOIA 2005 prevents the transfer of property to an unmarried child under 18. The question then arises whether the parent can transfer their property to a married child under 18 or a child over 18 to reduce tax. This form of tax avoidance will be prevented by the settlement rule in Section 624 (1) the ITTOIA 2005 for following reasons.

(a) Section 629 (1) does not apply where income arising from a settlement is received by a child who is under 18 and married or a child who is over 18.

[1035] Tiley, op.cit.(note141), p.149

[1036] Section 629 (7) (a), the ITTOIA 2005 defines that "child" includes a stepchild.
Section 629 (7) (b), the ITTOIA 2005 defines that "minor" means a person under the age of 18 years, and "minor child" is to be read accordingly.

[1037] Section 620 (1), ITTOIA 2005

[1038] Section 629 (3) , ITTOIA 2005

(b) Section 629 (1) does not apply where income arising from a settlement is treated as the income of the settlor under Section 624 (1).

(c) Section 624 (1) (b) applies where income arising from the settled property in which the settlor has an interest shall be treated as the income of the settlor.

(d) Section 620 (1) defines the term "settlement" as including any disposition, trust, covenant, agreement, arrangement or transfer of assets.

The above reasons imply that where Section 629 (1) does not apply to income arising from the transfer of property to a married child under 18 or a child over 18, the income will be treated as that of the transferor-parent under Section 624 (1). Accordingly, the income will be taxed as if it belonged to the transferor-parent, unless the transferor-parent can prove that he/she has no interest in the transferred property.

5.4.1.5 Reductions in tax rates

Reductions in tax rates may discourage tax avoidance by married couples transferring their investment income. As Messere notes, "...with the flattening of tax rate schedules, [tax avoidance by couples artificially splitting their unearned income] has become a less serious problem."[1039]

The UK tax rates for savings income and dividends are at some levels lower than those for earned income. This implies that the present UK law may affect spouses' decisions on the transfer of investment income to lower-earning spouses or children to avoid tax. However, reductions in tax rates for savings income and dividends will lead to inequity. This is because with equal taxable incomes, married couples who have only earned income will pay more tax than those who have savings income and dividends.

In Chapter Two, my research proposed that unearned income should be taxed at the same rates as earned income, i.e. those under the proposed two tax-rate schedules. As we have seen, the proposed two tax-rate schedules contain few and low tax rates. Therefore, the proposed two tax-rate schedules are likely to discourage

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[1039] Messere, op.cit.(note240), p.257

tax avoidance by married couples transferring their investment income and to reduce inequity of taxation.

5.4.2 Prevention of tax avoidance under joint taxation in Thailand

Tax avoidance actions under joint taxation could include cohabitation, divorce, and separation of a married couple throughout the tax year. Besides these, underreporting incomes and failing to file a return are tax evasion. Such avoidance and evasion can be prevented by social and legal measures as follows:

(a) difficulty in finding evidence,

(b) social and legal problems,

(c) penalties and punishments, and

(d) anti-avoidance rules.

5.4.2.1 Difficulty in finding evidence

Where a married couple avoids paying higher tax on their joint income by claiming that they live separately in a permanent manner throughout the tax year, a husband must produce evidence to convince tax-gatherers that he and his wife live apart in such a manner. It is not easy for a husband to find such evidence because he and his wife may not do as they claim in practice.

If a husband and wife occasionally live in different localities or occasionally live apart, they are deemed by law to be living together and they are still taxed on their joint income. If a husband produces any false evidence of permanent separation, he will be punished with imprisonment of three months to seven years and a fine of 2,000 to 200,000 baht.[1040] However, if a husband and wife permanently live apart throughout the tax year in reality[1041], this may not be difficult to prove and may convince tax-gatherers but may cause family trouble.

5.4.2.2 Social and legal problems

Tax avoidance by divorce is not difficult for a married couple. They may simply go to the Thai Registrar's Office to register the divorce. As for cohabitation, no

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[1040] Section 37, RCT

evidence is required to support tax avoidance. However, the subsequent social and legal problems of tax avoidance are likely to affect taxpayers' decisions to avoid tax by divorce or cohabitation.

Divorce for tax saving that is a disguised divorce in the legal sense may lead to divorce in fact, which causes family[1042] and social problems.[1043] Furthermore, a married couple getting a divorce and continuing to live together without marriage registration or two single persons cohabiting may lead to the following legal problems.

(a) The ownership rights of money and property that a couple gains during cohabitation are different from those received during marriage under Thai family law.[1044]

(b) The status of children born of cohabitants differs from the legal status of children born of a married couple under Thai family law.[1045]

(c) The inheritance rights of partners of a cohabiting couple and illegitimate children are not the same as those of a married couple and legitimate children under Thai succession law.[1046]

Owing to the social and legal problems mentioned above, tax avoidance may not of interest to some married couples.[1047]

5.4.2.3 Penalties and punishments

A husband who reports false or inadequate information about his own income and/or his wife's income in his tax return is liable to a penalty equal to the amount of tax additionally payable[1048], and shall pay a surcharge of 1.5% per month, or fraction thereof, of the tax payable exclusive of penalties.[1049] Additionally, the husband will

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[1041] For example, a husband lives with a mistress; or, a husband and wife have separated permanently under an order of the court.

[1042] Somchai Richupan, "Tax laws of other countries on taxation of married couples", RD Tax Journal, September-October 1976, 76.

[1043] Laohapun, op.cit.(note874), p.195

[1044] Section 1533, CCCT

[1045] Section 1547, CCCT

[1046] Section 1629, CCCT

[1047] However, other couples may be interested in tax avoidance if they think they can gain more benefit from tax avoidance than loss from social and legal problems.

[1048] Section 22, RCT

[1049] Section 27, RCT

be punished with imprisonment of three months to seven years and a fine of 2,000 baht to 200,000 baht.[1050]

As for failing to file the tax return on his own income and/or on his wife's income, a husband is liable to a penalty equal to twice the amount of tax payable[1051], and shall pay a surcharge of 1.5% per month, or fraction thereof, of the tax payable exclusive of penalties.[1052] Additionally, the husband will be punished with a fine not exceeding 5,000 baht or imprisonment not exceeding six months, or both.[1053]

5.4.2.4 Anti-avoidance rule

As noted earlier, joint taxation prevents tax avoidance by inter-spousal transfer. Additionally, there is an anti-avoidance rule to prevent the switching of investment income from parents to children under Thai law.

Children pay tax separately from their parents under Thai law. As a consequence of this loophole, parents could reduce their tax liabilities by shifting their investment income or income-producing assets so as to be in their children's names. However, Thai law has rules to prevent this form of tax avoidance. The rules are found in Paragraphs Two and Three of Section 40 (4) of the RCT as follows: -

(1) the dividend income of a *lawful* child[1054] or an *adopted* child who is a minor shall be treated as the income of the father if such child is a minor and the marital status of parents has been stable throughout the tax year;

(2) however, if the marital status of parents has not been stable throughout the tax year for reasons such as divorce, the child's dividend income shall be treated as the income of the parent who exercises parental power, or of the father if parental power is jointly exercised.

However, there are still loopholes in these rules.

Firstly, the above rules only apply to the dividend income of a lawful child and an adopted child who is a minor. The rules should also apply to the dividend income of an *illegitimate* child[1055] who is a minor.

[1050] Section 37, RCT
[1051] Section 26, RCT
[1052] Section 27, RCT
[1053] Section 37 bis, RCT
[1054] A lawful child means a child whose parents make marriage registration at the Registrar's Office.

Secondly, the above rules only apply to the dividend income of a *minor*[1056] child. This implies that parents may switch their shares to their *adult*[1057] son or daughter who has no other income or has other income which is subject to a lower tax rate. To prevent the transfer of shares from parents to their *adult* son or daughter, it is recommended that the rules on settlements and outright gifts in Section 624 (1) and Section 626 (1) (2) (3) (4) of the ITTOIA 2005 should be adapted to Thai law. The following are the proposed additional rules.

(a) The parent who transfers shares will be taxed on dividends if the transferor-parent or his/her spouse still retains an interest in the transferred shares; or the transferred shares could be applicable for the benefit of the transferor-parent or his/her spouse or returned to the transferor-parent or his/her spouse in the future, except where the transferred shares revert to the transferor-parent or his/her spouse as an estate.

(b) An *adult* son or daughter who receives shares as outright gifts will be taxed on dividends arising from such shares; but the parent who makes the gift will be taxed on dividends if-

    (i) the donor-parent can still control and retain a benefit in the given shares, or

    (ii) the gift is a right to receive income (dividends), or

    (iii) the gift that is made is subject to conditions, or

    (iv) the gift that is made will be applicable for the benefit of the donor-parent or returned to the donor-parent in the future, except where the gift reverts to the donor-parent as an estate.

In this regard, the term *adult* should include *lawful*, *adopted* and *illegitimate* son or daughter.

[1055] An illegitimate child under Thai Family Law means a child whose parents fail to make marriage registration at the Registrar's Office.

[1056] A minor under Thai Family Law means:-

(1) a person whose age is under 20, or

(2) a person whose age is under 17 and unmarried.

[1057] An adult under Thai Family Law means:-

(1) a person whose age is above 20, or

(2) a person whose age is above 17 and married.

Thirdly, the rules in Paragraphs Two and Three of Section 40 (4) only prevent tax avoidance by the shifting of shares from parents to children, but do not prevent the shifting of interest income or the transfer of bank accounts from parents to children. To close this loophole, the rules in Paragraphs Two and Three of Section 40 (4) should also apply to the shifting of interest income or the transfer of bank accounts from parents to *minor* children. In this regard, the term *minor* should include *lawful*, *adopted* and *illegitimate* child.

Furthermore, in order to prevent the shifting of interest income or the transfer of bank accounts from parents to an *adult* son or daughter, the rules on settlement and outright gifts in Section 624 (1) and Section 626 (1) (2) (3) (4) of the ITTOIA 2005 should be adapted into Thai law. The adaptation in this case should be similar to that for preventing the transfer of shares from parents to their *adult* son or daughter as discussed above. In this regard, the term *adult* should include *lawful*, *adopted* and *illegitimat*e son or daughter.

Fourthly, the rules in Paragraphs Two and Three of Section 40 (4) do not prevent the shifting of rental from parents to children. Additionally, a person who is a lessor need not be the owner of leased premises.[1058] If the parents who own property want to let it, they may make a lease contract under the name of their son or daughter as a lessor. Consequently, the rental income will be treated as that of the child who is liable to income tax. This is tax avoidance by shifting rental from parents to children. To prevent this form of tax avoidance, the following five measures are recommended.

(a) The child's rental income should be treated as the income of the father, if such child is a *minor*, or as the income of the parent who exercises parental power. In other words, the rules in Paragraphs Two and Three of Section 40 (4) should also apply in this case.
(b) The rental arising from a lease contract made under the name of an *adult* son or daughter as a lessor will be treated as that of the parent who is the owner of the leased property.

[1058] Section 537, CCCT

(c) The parent who lets out property and thereafter transfers the right to receive the rental to an *adult* son or daughter will be taxed on such income.

(d) Where the parent transfers property (such as land and buildings) to an *adult* son or daughter in order for them to let it out later on, the transferor-parent will be taxed on the rental income if-

  (i) the transferor-parent or his/her spouse can still control and retain an interest in the transferred property,

  (ii) the transferred property is subject to any condition under which the transferor-parent or his/her spouse may benefit, or

  (iii) the transferred property could be applicable for the benefit of the transferor-parent or his/her spouse or returned to the transferor-parent or his/her spouse in the future, except where the transferred property reverts to the transferor-parent or his/her spouse as an estate.

(e) The term *minor* should include *lawful*, *adopted* and *illegitimate* child. The term *adult* should include *lawful*, *adopted* and *illegitimate* son or daughter.

Measures (c) and (d) are adapted from the rules on settlements and outright gifts in Section 624 (1) Section 626 (1) (2) (3) (4) of the ITTOIA 2005.

6. Conclusion

Neither joint nor individual taxation is better than the other. The transformation of one system into another may bring about efficiency of taxation but discourage equity, or *vice versa.* The following methods would reduce the conflict between them.

Firstly, the rules of separate assessment under Thai law should be revised to reduce the discretion of the assessment officer.

Secondly, the rules of wife's election under Thai law should be abolished.

Thirdly, the progressive rate structure, which contains low MTRs together with few and wide tax bands, should be used with joint taxation. This would help reduce the disincentive effect while achieving equity. This type of rate structure also helps reduce inequity and maintain efficiency under individual taxation.

Fourthly, the abolition of a married couple's allowance is supported on the grounds that it has lessened inequity between married and single taxpayers while increasing efficiency under individual taxation.

Fifthly, Thai law should provide an allowance for the taxpayer's spouse only to a married person whose spouse stays at home because of old age, poor health, or the necessity of staying at home to care for relatives.

Sixthly, the additional personal allowance available to a childless married person whose spouse stays at home but cannot do housework because of old age, poor health, or the need to stay at home to care for a relative should be introduced to individual taxation.

Seventhly, UK anti-avoidance rules should be supported. They help prevent tax avoidance by the transfer of property between spouses and by the transfer of property to an unmarried child under 18, a married child under 18 or a child over 18. Consequently, they encourage equity and efficiency.

Finally, the rules on settlements and outright gifts should be adapted to Thai law. This would close loopholes to avoid tax by shifting investment income from parents to children.

Chapter Five

Efficiency in Tax Legislation and Administration

1. Introduction

This chapter discusses efficiency in Thai and UK tax legislation and administration. Simplicity and certainty of tax laws are supposed to help tax policies and optimal tax structures to promote efficiency of taxation and the equity of income redistribution. Meanwhile, simple, certain and convenient methods of tax collection are believed to help generate efficiency in tax administration, which would reduce administrative and compliance costs and prevent tax avoidance and evasion.

2. Characteristics and effects of efficient tax legislation and administration

Complex legislation is difficult to understand, making it hard to comply with and administer, and contributing to high compliance and administrative costs.[1059] Complexity also leads to tax avoidance and evasion, arbitrariness and bribery.[1060] Simplicity and certainty of tax laws and simple, certain and convenient methods of tax collection are therefore believed to have the opposite effects. This view is well supported.[1061]

However, Morse and Williams argue that:

> "The simpler the rules are, the less fair they are (because they ignore justified differences). But the fairer they are, the more complex they are. The more complex they are, the harder they are to understand and put into effect. Therefore, they are less certain and, arguably, appear less fair. If both simplicity and complexity lead to unfairness, is there a happy medium?"[1062]

I agree that the complex rules bring about fairness. Complex rules result from a complex policy on the tax structure. However, the complex rules are difficult to understand, to comply with and to administer. There are two stages to making the rules less complex and bringing about fairness at the same time.

[1059] Sandford, op.cit.(note58), p.155; The Musgraves, op.cit.(note5), p.290; and James and Nobes, op.cit.(note5), pp.38-39

[1060] The World Bank, op.cit.(note112), pp.26-27

[1061] The Musgraves, op.cit.(note5), p.291; and The World Bank, op.cit.(note112), p.7

[1062] Morse and Williams, op.cit.(note15), p.8

First, we must use a less complex policy on tax structures, for example a policy on optimal tax structures as proposed in Chapters Two, Three, and Four. As we saw, optimal tax structures can be achieved by less complex rules. Although rules on optimal tax structures are less complex than some possibilities, they can still promote fairness and efficiency of taxation. For example, optimal tax rates that require few marginal tax rates and tax bands, and the optimal tax base that require the abolition and maintenance of certain tax reliefs could reduce tax burdens on low-income earners, and administrative and compliance costs.

Secondly, the rules will be easy to comprehend and to access and bring about fairness simultaneously, when a policy on optimal tax structures is enacted to become a tax law, if its characteristics (i.e. the structure of tax code, the wording of tax provisions and the rules of structural elements) are simple and certain.

Simplicity and certainty in tax laws

'Simplicity' of the tax law should mean that

(a) the structure of tax code or a set of tax provisions is straightforward and consistent; and that

(b) the wording of tax provisions is plain, understandable, straightforward and consistent.

As the Meade Report notes, "a good tax system should be coherent, simple, and straightforward."[1063].

Meanwhile, 'certainty' of the tax law should mean that

(a) rules on structural elements (including tax rates, tax base, and tax unit) are clear, reliable, foreseeable and non-arbitrary;

(b) the wording of tax provisions is clear and unambiguous; and that

(c) the structure of tax code must be clear.

Many scholars support and comment on these terms. As regards (a), Tiley notes, "certainty means first that the scope of the tax should be clear."[1064] Smith also claims (a) that "the tax which an individual is bound to pay ought to be certain and not arbitrary."[1065] Similarly, Eckstein notes, "tax collectors should have little

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[1063] IFS, op.cit.(note98), p.18
[1064] Tiley, op.cit.(note141), p.11
[1065] Adam Smith, The Wealth of Nations, Edwin Cannan, ed. (New York: The Modern Library, 2000), 888.

discretion about how much to assess taxpayers."[1066] Richupan supports both (a) and (b) that a good tax must be clear with regard to tax rates, tax base, and tax unit; and that tax provisions must employ clear and undoubted wording.[1067] Pinitpuvadol also supports both (a) and (b) that rules on tax structures must be enacted clearly and unambiguously so that taxpayers can calculate the taxes they will pay.[1068]

Simple, certain and convenient methods of tax collection

'Simple' should mean easy, plain and straightforward without complication. 'Certain' should mean transparent.

Smith supports these two meanings. As he notes, "the time of payment, the manner of payment, the quantity to be paid, ought to be clear and plain to the contributor, and to every other person."[1069] Tanzi and Zee also support these two meanings. As they note, "the system should have simple and transparent administrative procedures so that it is clear if the system is not being enforced as designed."[1070] Pinitpuvadol understands 'certain' methods to mean that tax assessment and collection must be enacted clearly and unambiguously.[1071]

As regards 'convenient' methods, Smith notes, "every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it."[1072] However, the place, time and methods of collection and payment of taxes should be convenient not only for taxpayers but also for tax-gatherers.

Effects of efficient tax legislation on efficiency of taxation

If tax laws are enacted under the definition of simplicity above, it will be easy for taxpayers to understand and to comply with them, and easy for tax-gatherers to understand and administer them. This will result in low compliance and administrative costs. Additionally, it is likely that few tax loopholes result from simplicity.

[1066] Eckstein, op.cit.(note49), p.58
[1067] Somchai Richupan, "General Knowledge of Taxation", RD Tax Journal, Year 29, Issue 5, p.178
[1068] Supparak Pinitpuvadol, Fiscal and Taxation law (Bangkok: Vinyuchon, 1999), 67.
[1069] Smith, op.cit.(note1065), p.888
[1070] Tanzi and Zee, op.cit.(note108), p.6
[1071] Pinitpuvadol, op.cit.(note1068), p.67
[1072] Smith, op.cit.(note1065), p.889

One cause of tax loopholes is the complexity of many tax provisions. For example, "the more exemptions, concessions, reliefs, etc accorded within a tax, the more opportunities for avoidance are created."[1073] A reduction in tax provisions (e.g. by abolishing certain tax reliefs) is likely to reduce legal complexity and close tax loopholes. In the UK, during the 1980s and 1990s, there was an attempt to reduce a number of provisions relating to tax reliefs to simplify the legislation and close tax loopholes.[1074]

Another cause of tax loopholes is that complex legislation, which is difficult to understand and interpret, causes disputes over the language in tax provisions. Such disputes lead to loopholes for tax avoidance. Simplicity would close such loopholes because it is not difficult to understand and to interpret simple rules and words. Consequently, disputable language would not be found in tax provisions.

If tax laws are enacted under the term 'certainty' above, tax avoidance and evasion will be reduced. Clear, reliable and foreseeable rules help determine the precise amount of tax due. Consequently, they will prevent any opportunity for tax avoidance. They will also prevent tax evasion because they make it "more easily detectable."[1075] Consequently, administrative costs on the prevention and detection of tax evasion will be reduced.

Additionally, if tax laws do not rely on arbitrary decisions, tax-gatherers will have less chance to abuse their power in collecting taxes or to take bribes. Conversely, "the uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt."[1076] Consequently, discouraging the abuse of power and corruption of tax-gatherers will help increase tax revenue.

Effects of efficient tax collection on efficiency of taxation

If collecting methods are established under the terms 'simple, certain and convenient', taxpayers and tax-gatherers will save resources in paying and levying tax. Low compliance costs are likely further to reduce resentment and resistance to pay tax, discouraging tax evasion.

[1073] Sandford, op.cit.(note58), p.161

[1074] Lymer, et al., op.cit.(note120), pp.1/20-1/21

[1075] Adrian Shipwright and Elizabeth Keeling, Textbook on Revenue Law (London: Blackstone Press Limited, 1997), 11.

Furthermore, tax evasion will be probably discouraged because it is easily discovered under certain or transparent methods. Certain or transparent methods also provide fewer opportunities for tax-gatherers to abuse their power and to take bribes.

Moreover, tax avoidance is likely to be prevented because simple and certain methods will reduce complication in collection. This will further reduce tax loopholes and avoid disputes in collection methods.

It can be concluded that simplicity and certainty of tax laws and simple, certain and convenient methods of tax collection generate low compliance and administrative costs and prevent tax avoidance and evasion, arbitrariness and bribery. This encourages efficiency of taxation.

Effects of efficient tax legislation and collection on income redistribution

As noted in Chapter One, any means of encouraging efficiency of taxation would further promote income redistribution. Simple and certain tax laws and simple, certain and convenient methods of tax collection facilitate greater equitable redistribution of income. This is because:

(a) they would prevent avoidance and evasion (such prevention promotes both efficiency of taxation and redistribution, as discussed in previous chapters); and

(b) they would raise more tax revenue because there would be (i) more people willing to pay tax because of lower costs on compliance, (ii) less tax avoidance and evasion, and (iii) less arbitrariness and bribery.

Greater tax revenue would contribute to a greater transfer of resources via the tax system to the system of public expenditure. Consequently, the poorest would be better off from improvements in public services. Furthermore, low- and middle-income groups would also be better off from better public services funded by greater tax revenue. Moreover, lower costs of tax compliance incurred by these groups would encourage equity because these groups would bear a smaller burden in the taxing process.

[1076] Smith, op.cit.(note1065), p.889

3. Acts of Parliament and legislative process

3.1 Features and problems

As noted above, efficient tax legislation must be simple and certain. Here, I will examine whether Thai and UK primary tax laws satisfy this criterion and the passing of taxing Acts in both countries produces simple and certain legislation.

3.1.1 Acts of Thai Parliament and legislative process

The main source of Thai tax law is Acts of Parliament.[1077] Parliament is the supreme institution of the state with power to enact tax laws subject to the Constitution.[1078] Under the Constitution, the enactment of taxing Act depends on the introduction by members of the House of Representatives with the endorsement of the Prime Minister.[1079] A taxing bill is enacted as taxing Act when it is examined and consented by the National Assembly.[1080]

The National Assembly or Parliament consists of the House of Representatives and the Senate. Members of the House of Representatives and of the Senate are elected by Thai citizens. Therefore, Thai taxing Acts are subject to political debate and proper parliamentary scrutiny. This complies with a good tax system which requires tax legislation to be enacted by statute and "subject to proper democratic scrutiny by Parliament."[1081]

Parliament has the right to pass taxing Acts at any time to impose taxes or duties, or to make changes to existing tax provisions (deletions from or amendments to existing provisions, or the introduction of new provisions). Nevertheless, such changes have not contributed to legal complexity and confusion. Evidence for this is that between 1938 and 1998, there were 310 sections in the Revenue Code of Thailand (the RCT) although changes to the RCT were made 54 times during this

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[1077] These include the Excise Tax Act, the Customs Act, and the Act promulgating the Revenue Code governing PIT, VAT, corporation tax, specific business tax, and stamp duty.
[1078] The provisions of the Constitution concerned are found in **Appendix I to Chapter Five.**
[1079] Sections 92, 93 and 169, the Constitution
[1080] Section 92, the Constitution
[1081] Francesca Lagerberg, "Ten Tax Tenets", Taxation, 28 October 1999, p.76

period.[1082] There are presently 311 sections in the RCT. Reasons why Acts of Parliament have not caused complexity and confusion are that:

(a) Parliament does not pass taxing Acts to change tax provisions frequently,[1083] nor pass an annual Finance Act in relation to taxation[1084]; and

(b) Thailand has adopted the system of codification.

Codification makes Thai primary tax law to satisfy the criteria of simplicity and certainty because according to this codification, there is a single/parent Act (e.g. the RCT) with a consistent and well-organized structure. All changes to the parent Act by any subsequent Act of Parliament (e.g. the Revenue Code Amendment Act) will be placed in that structure. Such changes will therefore result in consistency of a set of tax provisions in that structure (i.e. compliance with simplicity) and not create confusion and difficulty in the application of tax law (i.e. compliance with certainty).

3.1.2 Acts of UK Parliament and legislative process

The main source of UK tax law is Acts of Parliament. Parliament has the sole authority to enact tax laws as shown in Article 4 of the Bill of Rights (1688) which provides:

> "That levying money for or to the use of the Crown by pretence of prerogative without grant of Parliament for longer time or in other manner than the same is or shall be granted is illegal."

It may be surprising that while so much of the UK legal system is based on common law, there is no tax based on common law.[1085] Therefore, if British people want to know whether or not they are subject to taxes, they need initially to seek Acts of Parliament imposing taxes[1086] rather than a court decision.

However, since the UK has been a member state of the European Community (now the European Union), there has been a limitation on the sovereignty of the UK

[1082] Suthep Pongpitak, "Question-Answer", RD Tax Journal, Year 46, Issue 4, pp.69 and 73.
[1083] Instead, Thai tax provisions are frequently changed by delegated legislation.
[1084] Each year Parliament is only required to pass an Act in connection with the Government's public spending plans ("the Annual Budget Expenditure Act.")
[1085] Morse and Williams, op.cit.(note15), p.35
[1086] These include the TA 1988, the ITEPA 2003, and the ITTOIA 2005 (as well as annual Finance Acts).

Parliament by the EC Treaty, and this includes tax matters. As Terra and Wattel confirm, "several fundamental principles of the EC Treaty limit Member States' freedom to arrange their national tax systems."[1087] The EC Treaty contains tax provisions which influence the power of enactment of the UK Parliament.[1088]

Parliament has the right to pass annual Finance Acts to amend existing provisions and to introduce new provisions to tax statutes. Income tax and corporation tax must be reimposed each year by the annual Finance Act. Income tax and corporation tax are also known as "annual taxes".

Each year (in March or April) the Chancellor of the Exchequer presents to Parliament the Budget proposing both the Government's revenue and taxation plans (the reimposition of annual taxes, amendments to existing tax statutes, and the introduction of new tax rules) and its public expenditure plans. The taxation matters announced in the Budget are incorporated in the annual Finance Bill. When Parliament passes the Bill under parliamentary procedures and the Bill is subsequently given the Royal Assent, the Bill will become law in the form of the Finance Act of that year.

Regarding parliamentary procedures, after the Budget debate[1089], the Finance Bill is proceeded to the following stages: First Reading, Second Reading, Committee, Report and Third Reading.[1090] First Reading is a formality at present.[1091] Second Reading is a general debate.[1092] Regarding the Committee Stage, "after the Second Reading debate, certain clauses are committed to a Committee of the whole House[1093], and the remainder to a Standing Committee of about 30 members who consider every clause and Schedule, make amendments and add new clauses."[1094] At the Report Stage, "the House of Commons reconsiders the Bill as amended at the

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[1087] Ben Terra and Peter Wattel, European Tax Law, 2nd ed. (London: Kluwer Law International, 1997), 2.

[1088] The provisions concerned can be found in **Appendix II to Chapter Five**.

[1089] Maas notes that "the Budget debate, i.e. the debate on the Ways and Means resolutions, is a general debate, not directed at specific provisions." (Robert Maas, "Why Parliament Fails Taxpayers", The Tax Journal, Issue 536, Monday, 21 February 2000, 11.)

[1090] Simon's Direct Tax Servic:Binder 2, op.cit.(note79) p.1106

[1091] Maas, op.cit.(note1089), p.11

[1092] ibid.p.11

[1093] Maas notes that "from 1968 onwards only a few clauses, selected by the Opposition, are debated in a Committee of the whole House [;] [the] remainder of the Bill is considered by a Standing Committee." (ibid.p.11)

[1094] Simon's Direct Tax Service:Binder 2, op.cit.(note79), pp.1106-1107

Committee Stage."[1095] In other words, at the Report Stage, "only new clauses, and clauses and Schedules to which amendments are proposed, are discussed."[1096] At the Third Reading Stage, "there is usually a short debate" and there is no amendment to the Bill.[1097]

When the Finance Bill has been passed by the House of Commons, it may be certified as a "money bill" by the Speaker.[1098] Additionally, the Bill is reprinted as amended and is presented to the House of Lords for consideration.[1099] After the Bill is given Second and Third Readings by the House of Lords, the Bill will receive the Royal Assent and become the Finance Act.[1100] Where the House of Lords has not passed the Bill within one month, the Bill can become an Act if it is certified as a money bill.[1101] Section 1 (2), Parliament Act 1911 defines a money bill as "one dealing only with matters of national (as opposed to local) taxation, public money or loans or their management; the Speaker's certificate is conclusive."[1102]

Although tax provisions in annual Finance Acts are subject to parliamentary procedures above, they do not receive proper parliamentary scrutiny. This stems from at least two factors.

First, parliamentary time does not allow for technical debate on every tax provision in the House of Commons.[1103] Certain tax provisions are passed without comment by the House of Commons.[1104] Similarly, "Parliament is given little time to study and debate proposed legislation."[1105] This stems from "a vast increase in the volume of parliamentary business and in particular the vast increase in the size of Finance Bills"[1106], and "the speed of introduction of much new legislation."[1107]

1095 Maas, op.cit.(note1089), p.11
1096 Simon's Direct Tax Service:Binder2, op.cit.(note79), p.1107
1097 ibid.p.1107
1098 ibid.p.1107
1099 ibid.p.1107
1100 ibid.p.1107
1101 ibid.p.1107
1102 Tiley, op.cit.(note6), p.49
1103 Morse and Williams, op.cit.(note15), p.36
1104 ibid.p.36
1105 Lagerberg, op.cit.(note1081), p.76
1106 Maas, op.cit.(note1089), p.11
1107 Lagerberg, op.cit.(note1081), p.76

Additionally, parliamentary time is "dominated by the needs of the Budget, rather than the Finance Bill which follows."[1108]

Secondly, even though the Finance Bill is presented to the House of Lords, the House of Lords has no power to initiate or amend tax provisions.[1109] This is because the House of Commons' financial privileges limit the powers of the House of Lords.[1110] Likewise, "the powers of the House of Lords are limited in relation to a money bill."[1111] It is noted that "in practice the House of Lords has never sought to amend or reject a Finance Bill since its rejection of the 1909 Bill precipitated the passage of the 1911 Parliament Act."[1112]

Amendment to existing tax statutes and the introduction of new rules by the enactment of annual Finance Acts make UK tax legislation flexible to economic and social changes. The question arises whether this enactment makes UK tax legislation complex. The enactment in respect of the reimposition of income tax (charge and rates) which includes the adjustment of personal tax allowances and tax bands for price inflation every year does not make UK legislation more complex. This is because it does not increase the number of tax provisions from previous years.

However, annual Finance Acts that change other existing tax statutes and introduce new tax rules increase the number of tax provisions.[1113] The growth in the volume of tax legislation result in legal complexity.[1114] Tiley refers to *Butterworths Yellow* and *Orange Tax Handbooks* (2004-05) and notes, "the number of pages of UK legislation on income and corporation tax and CGT (and statutory instruments)

1108 Geoffrey Howe, "Tax Law Simplification in the United Kingdom", Further Key Issues In Tax Reform, Cedric Sandford ed., (Bath: Fiscal Publications, 1998), 92.
1109 Simon's Direct Tax Service:Binder2, op.cit.(note79), p.1107
1110 ibid.p.1107
1111 David Collision and John Tiley, Simon's Tiley and Collision UK Tax Guide 2004-05, 22nd ed., (London: LexisNexis UK, 2004), 5.
1112 TLRC, Making Tax Law: Report of a Working Party on the Institutional Processes for the Parliamentary Scrutiny of Tax Proposals and for the Enactment of Tax Legislation Chaired by Sir Alan Budd, (London: IFS, 2003), 4.
1113 For example, the Finance Act 2002 added "another 500 or so pages to the already enormous mass of tax legislation." (Arnold Homer and Rita Burrows, Tolley's Tax Guide 2002-2003, 21st ed. (Surrey: Lexis Nexis Butterworths Tolley, 2002), xliv.)
1114 Adam Broke, "Simplification of Tax or I Wouldn't Start from Here", British Tax Review 2000 (London: Sweet&Maxwell, 2000), p.19

[in these handbooks] amounted to 6,908."[1115] However, in 1968-1969, "there were [only] 998 pages in *Butterworths Yellow Tax Handbooks*."[1116]

Additionally, annual Finance Acts create legal complexity by making frequent changes to the same legislation year after year.[1117] Furthermore, annual Finance Acts which introduce specific anti-avoidance provisions[1118] contribute to the large number of complex provisions.[1119] Moreover, annual Finance Acts which contain very long or highly detailed provisions result in complexity. As Wallworth notes, "tax law is written in traditional legal language, full of ... very long sentences in which subclauses are nested several deep so that when one reaches the end of the sentence one has forgotten how it began or what it is about."[1120]

It has been found that the frequency of change in tax law, the introduction of anti-avoidance provisions, and the growth in the number and length of tax provisions (through annual Finance Acts) stem from many factors, including the need to:

- keep up with and respond to "an increasingly global and sophisticated business environment"[1121],
- respond to "changes in the general legal framework within which businesses and other taxpayers operate"[1122],
- avoid "injustice in special cases"[1123] or implement "the desire for fairness"[1124]; and
- ensure legal certainty, which requires more detailed and precise provisions.[1125]

In addition to causing complexity, annual Finance Acts make UK tax laws lacking in clarity and almost in their inaccessibility to anybody except for skilled practitioners. This results from (a) the language used, (b) the style of drafting and (c) the lack of structure.

1115 Tiley, op.cit.(note6), p.51
1116 ibid.p.51
1117 Howe, op.cit.(note1108), p.89
1118 This issue will be further discussed in **subsection 6.2.**
1119 TLRC, op.cit.(note7), pp.viii and xiii.
1120 Christopher Wallworth, "Simplifying the System", Taxation, 25 January 1996, p.413
1121 Howe, op.cit.(note1108), p.89
1122 ibid.p.89
1123 Morse and Williams, op.cit.(note15), p.43
1124 Richard Baron, "Why Is Tax Complex", The Tax Journal, Issue 469, Monday, 28 September 1998, p.7

As regards (a), a result of tax statutes amended and supplemented by annual Finance Acts, tax statutes consist of archaic language and modern language. As Lagerberg notes, "some are relics from another age, while others are of a more modern vintage."[1126]

As regards (b), "the trend in fiscal legislation has been towards ever tighter drafting in an attempt to forestall avoidance."[1127] To prevent tax avoidance, the Tax Law Review Committee (the TLRC) notes that the draftsman uses a particular style "which avoids narrative passages or any repetition, but expressly links different parts of the text."[1128] Likewise, tax legislation is written in "an impenetrable style with no obvious way in."[1129] Additionally, the income tax law is written in a "convoluted style."[1130]

As regards (c), it is hard to find all the law dealing with a particular tax because the provisions of annual Finance Acts must be read in conjunction with the principal taxing Act.[1131] Likewise, the tax legislation is lacking in structure.[1132] Tiley notes that the legislation is understood when "one goes to secondary sources such as Hansard or the Inland Revenue background Materials where these are available."[1133]

Parliament has dealt with the above difficulty by adopting the system of consolidation, i.e. all the provisions (from various Acts) dealing with a particular tax is consolidated into a new Act from time to time.[1134] As regards the law relating to income tax, it was consolidated in 1918, 1952, 1970 and 1988.[1135] However, there are still problems arising from consolidation, namely:

(a) "its language and approach are not always consistent, and the old words are used in the consolidation legislation which are not always appropriate to modern conditions"[1136];

[1125] Howe, op.cit.(note1108), p.89; and Wallworth,op.cit.(note1120), p.411
[1126] Lagerberg, op.cit.(note1081), p.76
[1127] Broke, op.cit.(note1114), p.19
[1128] TLRC, Interim Report on Tax Legislation (London: IFS, 1995), 5.
[1129] ibid.p.5
[1130] Morse and Williams, op.cit.(note15), p.51
[1131] Wallworth,op.cit.(note1120), p.412
[1132] Tiley, op.cit.(note6), p.45
[1133] ibid.p.50
[1134] Melville, op.cit.(note 541), p.4
[1135] Tiley, op.cit.(note141), p.45
And in effect the new statutes deriving from the Tax Law Rewrite Project involve consolidation.
[1136] Shipwright and Keeling, op.cit.(note1075), pp.51-52

(b) a consolidation Act "can create its own problems of interpretation";[1137] and

(c) "frequent consolidating Acts are a source of major inconvenience to practitioners, who have to learn new section numbers and, usually, a new structure."[1138]

3.2 Improvements

3.2.1 Improvement in Thai primary legislation and legislative process

As we saw, the Thai Parliament is not required to pass annual Finance Acts in relation to taxation. Consequently, there is no adjustment of tax allowances and bands for inflation every year. Additionally, although Parliament can enact taxing Acts at any time, there may be a delay of Acts of Parliament to deal with economic and social changes if there is a delay by members of the House of Representatives (who are not directly responsible for taxation) to introduce a taxing bill. As a taxing bill is a money bill, it must be introduced to Parliament by members of the House of Representatives with the endorsement of the Prime Minister, under section 169, the Constitution.

If there were an annual compulsory Act relating to taxation introduced by the government (who is directly responsible for taxation), this would make Thai tax legislation more flexible to respond to social and commercial changes in addition to more equitable (because adjustment of tax allowances and bands for inflation would be made annually). I therefore propose to adapt the concept of an annual compulsory Act relating to taxation.

The enactment of the proposed Act would be subject to the provisions of the Constitution. It would make Thai tax legislation greatly efficient (simple and certain) if four subject-matters below were implemented.

First, section 169 of the Constitution must be amended to enable the Thai government to introduce a money bill.

1137 Michael Wyatt, "A Futuristic Framework", Taxation, 12 December 1996, p.302

1138 ibid.p.302

Secondly, the proposed Act must be subject to full parliamentary scrutiny. As noted above, a taxing bill is examined by the House of Representatives and the Senate. This ensures that the proposed bill would receive full parliamentary scrutiny. Additionally, the proposed bill should be presented to Parliament at a different timetable from the Annual Budget Expenditure Bill to allow Parliament to have much time to study and debate the proposed bill.

Thirdly, the process of public consultation before a bill to be presented to Parliament should be taken by the Revenue Department to enhance the quality of the proposed Act. This process should be adopted from that in the UK (to be discussed below.)

Fourthly, the proposed Act must not make Thai tax legislation unclear, inaccessible, incomprehensible and complex. To make Thai tax legislation clear, accessible and comprehensible, the wording in the proposed Act must be plain, unambiguous, straightforward, consistent, and not contain jargon and archaic words. Language should also not be too tight (e.g. no narrative passages and repetition) into which users cannot find a way. Furthermore, provisions in the proposed Act should not contain very long sentences, nor be written in a convoluted style (e.g. the use of much cross references.) The proposed Act should be written from detailed viewpoint to ensure legal precision and certainty.

The proposed Act would not tremendously increase the volume of tax legislation and legal complexity. This is because:

(a) there would be no provision for the reimposition of income tax and corporation tax (charge and rates) since these taxes are not annual taxes in Thailand;

(b) the adjustment of tax allowances and bands for inflation every year would not increase the number of tax provisions; and

(c) the introduction of new rules and amendments to the Revenue Code would be made where clearly inevitable and necessary (to be discussed more below).

3.2.2 Improvement in UK primary legislation and legislative process

In this subsection, I will examine and discuss (a) the improvement of parliamentary process, (b) the improvement for clearer and simpler primary legislation, and (c) solutions to the problems of consolidation.

3.2.2.1 Improvement of parliamentary process

As we saw, annual Finance Acts have not received proper parliamentary scrutiny, resulting from the time constraints for scrutinizing the Finance Bills and the limitation of the powers of the House of Lords in relation to a money bill. Here, I will examine and discuss the improvement of parliamentary process for proper scrutiny of tax legislation.

Greater time for the Pre-Budget Report

The first improvement is the greater time allowed to debate the Pre-Budget Report.[1139] The Pre-Budget report is presented in November of the previous year. The Budd Committee Report says, "this provides the Chancellor with the opportunity to expose for debate measures that he is currently considering for the following spring Budget."[1140] However, "the House of Commons has not taken advantage of this earlier notification to debate the government's proposals more extensively."[1141]

The process of the Pre-Budget Report in Parliamentary terms starts with a government statement by the Chancellor proposing changes in the tax system and spending plans[1142], and "followed by responses from the Opposition front bench and questions from backbenchers."[1143] In each of 2000, 2001 and 2002, this whole process took under 2 hours.[1144]

The Budd Committee Report proposes that Parliament should allow more time to debate the Pre-Budget Report.[1145] The advantage is that Members of the House of Commons could have more time for scrutinizing the government's tax proposals (before the Chancellor presents them in his spring Budget). And this would

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[1139] TLRC, op.cit.(note1112),p.1
[1140] ibid.p.7
[1141] ibid.p.7
[1142] Tiley, op.cit.(note6), p.27
[1143] TLRC, op.cit.(note1112), p.7
[1144] ibid.p.7
[1145] ibid.p.7

give Parliament a chance to engage in the parliamentary process to scrutinse tax legislation at an earlier stage[1146], which would help improve the quality of the annual Finance Act.

Extension for the deadline for enacting the annual Finance Bill

The resolutions of the Houses of Commons on tax measures announced in the Budget shall have temporary effect even though the Finance Act has not become the law. The temporary statutory effect to tax measures through Budget Resolutions derived from the Provisional Collection of Taxes Act 1913 (now PCTA 1968).[1147] It is noted that "[tax] measures given temporary effect in Budget Resolutions must be enacted by early August."[1148] Therefore, the time allowed for parliamentary scrutiny is restricted from the spring Budget to early August.

The Budd Committee Report proposes that the time required by the PCTA 1968 for giving this temporary statutory effect (and therefore the deadline for the enactment of annual Finance Bill) should be extended "from 5 August to 5 October for resolutions passed in February or March (and from four to six months for resolutions passed at other times)."[1149] This extension would give Parliament more time to scrutinize tax measures before they are enacted. This would be another improvement of parliamentary process to scrutinize tax legislation.

However, the government should not use this extension to introduce other new tax measures, particularly "substantial change to the Finance Bill increasing taxation or otherwise unfavourable to taxpayers."[1150] This is because Parliament may have fulfilled its obligation to scrutinize and authorize particular tax measures, and have little time to scrutinize those other measures. This would affect the quality of tax legislation.

Split of the Finance Bill into two

It is argued that if the annual Finance Bill were split into two (namely a short Finance Bill and a technical bill), this would solve the time constraints.[1151] A short Finance Bill would contain "provisions relating to the setting of tax rates and

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[1146] ibid.p.9
[1147] The history of PCTA 1968 can be found in **Appendix III**.
[1148] TLRC, op.cit.(note1112), p.8
[1149] ibid.p.2
[1150] ibid.p.9
[1151] Maas, op.cit.(note1089), p.11

allowances" [1152], or "measures that, for administrative or practical reasons, need to be enacted within a short time of their Budget announcement." [1153] Meanwhile, a technical bill would contain "the detailed anti-avoidance provisions, the changes to the existing rules to make them work effectively and other technical provisions that do not require Budget secrecy." [1154]

There is a proposal that a short Finance Bill would be presented to Parliament as usual, whilst "it might not be necessary to have a technical bill every year [,] perhaps every 18 months or every two years would suffice." [1155] The introduction of a technical bill to Parliament at a different timetable from a short Finance Bill would reduce the speed of introduction of much new legislation and give Parliament much time for scrutinizing anti-avoidance provisions and other changes to the existing rules as proposed in a technical bill.

Nevertheless, Governments have resisted the above proposal on the grounds that "there is no easy way to separate tax measures into two Bills and that Parliamentary time may not be forthcoming for [a technical bill] which is not subject to any special time constraints." [1156] Additionally,

> "Even if one assumes that Parliamentary time would be forthcoming for [a technical bill], it is unlikely that any of the Treasury, Revenue Departments or taxpayers would wish to extend unduly the time allowed to enact tax legislation. The Treasury and Revenue Departments will wish to move on to the next Pre-Budget and Budget cycle without the distraction of legislation in Parliament, and taxpayers are likely to prefer the greater certainty that the final enactment of the legislation brings. The Finance Bill also cannot realistically be included amongst legislative measures that can carry over to another Parliamentary session." [1157]

Due to the above objections, the proposal for splitting the annual Finance Bill into two could not really happen in the UK.

[1152] Simon McKie, "For Heaven's Sake, Just Leave Us Alone", The Tax Journal, Issue 586, Monday, 5 March 2001, 12.
[1153] TLRC, op.cit.(note1112), p.8
[1154] Maas, op.cit.(note1089), p.11
[1155] ibid.p.11
[1156] TLRC, op.cit.(note1112), p.9
[1157] ibid.p.9

Powers of the House of Lords

It has been found that "the House of Commons has neither the time nor the expertise nor, apparently, the inclination to undertake any systematic or effective examination of whatever tax rules the government of the day places before it for its approval."[1158] As we saw, the House of Lords has no power to interfere in and amend tax provisions. However, this House must certainly have members who have the tax expertise, which would help the House of Commons improve the parliamentary process for proper scrutiny of tax legislation. This can be deduced from the Budd Committee Report. [1159]

It is also noted that "the role of the House of Commons in authorising tax legislation is unique in terms of its relationship with government."[1160] This is implicit that the House of Lords has a less close relationship with the government than the House of Commons. Therefore, this House is likely to take the effective examination of the government' s tax proposals before enacting them as tax law.

From the above, if the House of Lords were conferred powers to initiate or amend tax provisions, this would solve the problem of lack of proper parliamentary scrutiny of tax legislation. Broke seems to supports this proposal. As he says,

> "The House of Lords has been a very valuable forum for revision of business legislation – for example company law has often been shaped there as much as in the House of Commons. But nobody imagines that the present reform of the House of Lords will give it a revising power over fiscal legislation, however sensible that might seem to non-politicians."[1161]

However, the implementation of above proposal is not easy. This is not only because it is a political issue but also because there must be change in constitutional restriction.

Pre-legislative scrutiny

The Modernisation Committee as referred to in the Budd Committee Report proposes that there should be pre-legislative scrutiny.[1162] This will help the

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[1158] ibid.p.5
[1159] The Report, paragraphs 6.2 and 6.4 (ibid.p.11)
[1160] ibid.p.4
[1161] Broke, op.cit.(note1114), p.24
[1162] The Report, paragraph 5.4 (TLRC, op.cit.(note1112), p.10)

Commons to scrutinise tax Bills "while they are still in draft."[1163] However, "legislation is not published in draft for every tax proposal."[1164] Therefore, it has been proposed that every tax proposal should be expressed "either as draft legislation or as a detailed statement [of policy] sufficient to initiate the process of Parliament scrutiny."[1165]

Although "the Revenue Department release in draft large amounts of tax legislation on particular proposals for [public] consultation"[1166], the Report has found that Parliament does not take part in public consultation on tax proposals.[1167] Therefore, in my view, if members of Parliament had a chance to take pre-legislative scrutiny in draft or in a detailed statement of policy, this would improve the parliamentary process for proper scrutiny of tax legislation. However, if members of Parliament had no or little time to take pre-legislative scrutiny, the establishment of a Parliamentary Committee would be the mechanism for taking parliamentary pre-legislative scrutiny.

Establishment of a Parliamentary Committee

The Budd Committee Report recommends that "the most effective way to increase Parliament's scrutiny of the government's taxation proposals would be by creating a Parliamentary Select Committee on Taxation."[1168] The Select Committee would "most appropriately be a Joint Committee of the two Houses."[1169] This would allow "members of the House of Lords with experience of and specialist knowledge of tax matters, and with the time, to contribute to Parliament's consideration of these matters."[1170]

The Select Committee would have the duty to scrutinize the government's tax proposals prior to the incorporation/introduction of tax proposals into a Finance Bill (or the pre-legislative function).[1171] This function might bring about fairness of

[1163] ibid.p.10
[1164] ibid.p.10
[1165] ibid.p.10
[1166] ibid.p.10
[1167] The Report, paragraphs 3.6, 3.7 and 5.5 (ibid.p.7 and p.10)
[1168] ibid.p.11
[1169] ibid.p.11
[1170] ibid.p.11
[1171] The Report, paragraphs 6.3, and 6.7 (ibid.p.11 and p.12)

taxation, and prevent unnecessary and poor tax policy from becoming tax law. This would improve tax law and make it simpler.

As the Select Committee would deal with "current tax proposals rather than with legislation that was before parliament for enactment"[1172], a creation of the Select Committee would not violate "the current prerogatives of the House of Commons in tax legislation."[1173] That is, tax measures would continue to be debated according to the current Finance Bill process and "in particular be subject to the scrutiny of a Finance Bill Standing Committee."[1174]

Nevertheless, the Budd Committee Report notes that "Members of Parliament are not naturally equipped to conduct an effective scrutiny of tax legislation at the legislative stages and the process of debate across the floor of the House is also poorly suited to the task."[1175] It then proposes that "[the] task would be better performed by [the Select Committee], with the ability to take evidence and to arrive at a balanced understanding of the issues in an atmosphere that lends itself to question and answer as a means of resolving points in issue."[1176] And, "[in] enacting the government's tax proposals, the House will be informed by the work of the Select Committee on Taxation."[1177] Therefore, this proposal for the Select Committee's function during the legislative stages of the Finance Bill would also help improve the parliamentary process for proper scrutiny of tax legislation.

Consultative process

In addition to the methods of improving the parliamentary process (as discussed above), public consultation before a taxing bill is presented to Parliament would improve the quality of tax legislation. This is because it can:

- allow "the airing of views and the deliberation of issues"[1178];
- "help build upon a sound idea, turning it into good legislation"[1179]; and

[1172] ibid.p.11
[1173] ibid.p.11
[1174] ibid.p.12
[1175] ibid.p.12
[1176] ibid.p.12
[1177] ibid.p.12
[1178] Frank Haskew and Francesca Lagerberg, "Why the taxpayer is not getting a fair chance to be heard", The Tax Journal, Issue 536, Monday, 21 February 2000, p.13
[1179] ibid.p.13

- "be the brake on poorly conceived ideas, thus preventing them from becoming tax law."[1180]

The UK government recognizes the importance of consultation.[1181] The evidence is that the Cabinet Office published its final Code of Practice on Written Consultation on 27 November 2000.[1182] The Treasury and Revenue Departments adopt this Code when they consult publicly.[1183]

According to the Cabinet Office Code, "consultation should always be as wide as the circumstances permit [;] [other] things being equal, public consultations are preferable to closed ones."[1184] In a matter of taxation, the consultative process should take place from the stage of "the formulation of tax policy to the design of tax proposals and the detail of implementation to tax policy."[1185]

The revenue authorities have certain excuses for not consulting, e.g. "market sensitivity, forestalling, anti-avoidance etc."[1186] It is however argued that "there should be an obligation to consult on all other matters" unless "the measure is stated to be an anti-avoidance measure."[1187] Additionally, the revenue authorities should not avoid public consultation on the grounds that consultation will lead to substantial revenue loss "if legislation is not brought in swiftly."[1188] This is because this situation is rare.[1189] It is recommended that the revenue authorities can avoid consultation when they have serious and substantive reasons, and in such cases "these reasons should be made publicly available"[1190] and "these reasons should be subject to review by a 'independent' body, for example a parliamentary committee."[1191]

1180 ibid.p.13
1181 Frank Haskew, "Effective consultation: has the Government taken the pledge?", The Tax Journal, Issue 586, Monday, 5 March 2001, p.16
1182 ibid.p.16
1183 TLRC, op.cit.(note1112), p.6
1184 Haskew, op.cit.(note1181), p.17
1185 TLRC, op.cit.(note1112), p.6
1186 Haskew, op.cit.(note1181), p.p.18
1187 ibid.p.18
1188 Lagerberg, op.cit.(note1081), p.77
1189 ibid.p.77
1190 ibid.p.77
1191 Haskew and Lagerberg, op.cit.(note1178), p.14

According to the Cabinet Office Code, "sufficient time should be allowed for considered responses from all groups with an interest."[1192] The standard time allowed for consultation is twelve weeks according to the Code.[1193] It is however argued that where a consultation period is less than twelve weeks, it should not be less than eight weeks "unless there are extenuating and publicly documented reasons why this is not possible."[1194] According to the Code, circumstances which unavoidably require a consultation period of less than twelve weeks include "those tied to the Budget or other annual financial cycles."[1195]

Feedback from the revenue authorities should be provided during and after consultation. Feedback is important partly because it explains the reasoned exposition behind decisions of the revenue authorities.[1196] According to the Cabinet Office Code, "the results [from the departments] should be made widely available, with an account of the views expressed and the reasons for the decisions finally taken"[1197]; and "departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated."[1198]

From the above, public consultation is vital for developing the government's tax policy and producing its tax proposals to implement that policy.[1199] The good-quality proposals would guarantee the good quality of tax legislation. Nevertheless, the Budd Committee Report notes that "consultation is not and should not become a substitute for Parliamentary scrutiny [;] [tax] proposals should move seamlessly from development via consultation to effective Parliamentary pre-legislative review."[1200]

3.2.2.2 Improvement for clearer and simpler legislation

In 3.1.2, I found that the present UK tax legislation is complex, lacking in clarity, and almost inaccessible and incomprehensible by anybody. These characteristics of tax legislation do not satisfy the criteria of simplicity and certainty. They result from

1192 Haskew, op.cit.(note1181), p.18
1193 ibid.p.18
1194 ibid.p.18
1195 ibid.p.18
1196 Haskew and Lagerberg, op.cit.(note1178), p.14
1197 Haskew, op.cit.(note1181), p.18
1198 ibid.p.18
1199 TLRC, op.cit.(note1112), p.7
1200 ibid.p.7

many factors including language, frequent change, volume, long provisions, drafting style, lack of structure, anti-avoidance provisions. Thus, such factors must be improved to bring about clearer, simpler, more accessible and comprehensible legislation.[1201]

Language

To make the language clearer and more accessible, the TLRC recommends that tax legislation should be written in plain English[1202] and not contain jargon.[1203] The Renton Committee as referred to in the TLRC' s report suggests using simple vocabulary and syntax.[1204] The following technique as referred in Wallworth is also recommended:

> "[To] throw out all those so-called legal words which are actually meaningless: any word beginning with here ... (herein, hereinafter *etc.*), there ... (therein, thereto, thereof *etc.*) or ending in ...soever (whatsoever, wheresoever), and that little word without which any traditional legal document would be incomplete, 'the same' meaning 'it'."[1205]

Wallworth also proposes to use one word in place of several words, e.g. 'In the event that' can be replaced by 'if'.[1206]

Frequency, Quantity, Length

The Tax Faculty of the Institute of Chartered Accountants challenges the assumption that "it is necessary to make changes to tax policy every year and undertake only to alter tax legislation when such change is clearly necessary."[1207] Likewise, Broke recommends that income tax should no longer be an annual tax; and he encourages "Governments to free up legislative time by having biennial or even triennial Finance Acts."[1208] Both recommendations may reduce the frequency of changes in tax legislation and the volume of tax legislation.

In my view, biennial or triennial Finance Acts may mean a delay in dealing with new commercial developments. Consequently, horizontal inequity may emerge

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[1201] Anti-avoidance provisions will be discussed in **section 6.**
[1202] TLRC, op.cit.(note7), p.1
[1203] TLRC, op.cit.(note1128), p.vii
[1204] ibid.p.33
[1205] Wallworth, op.cit.(note1120), p.413
[1206] ibid.p.413
[1207] McKie, op.cit.(note1152), p.11
[1208] Broke, op.cit.(note1114), p.26

because some taxpayers could have opportunities to avoid tax and take tax benefits for a long period through new businesses; whilst, others are unable to do so. An annual Finance Act can reduce a delay in closing off such opportunities. Another merit is that tax allowances and bands can be adjusted for price inflation every year, which would reduce tax inequity (as discussed in Chapters 2 and 3). Therefore, annual Finance Acts are still needed although they do not solve the problem of frequency.

However, I agree that changes to existing tax statutes should be made when such changes are clearly inevitable and necessary. This would reduce the quantity of legislation. The question then arises when changes are clearly inevitable and necessary. In my view, the government's tax proposals to be enacted as the tax provisions of annual Finance Acts should be produced only to:

- strengthen the tax base to respond to new commercial developments,
- prevent tax avoidance,
- avoid injustice/inequity,
- promote fairness, the equity of income redistribution, efficiency of taxation,
- promote legal certainty, and
- respond to changes in the general legal framework.[1209]

The above criteria to limit tax proposals mean the limitation of using tax policy to achieve social and economic purposes. A limited tax policy or a less complex policy would make tax legislation simpler. The TLRC supports the view that "simpler policy would allow simpler legislation."[1210] However, as quoted earlier, "the simpler the rules are, the less fair they are."[1211] As discussed in section 2, if we used a less complex policy under the idea of optimal tax structures (as proposed in Chapters Two, Three, and Four), this could make tax legislation less complex and still bring about fairness at the same time.[1212]

When changes to existing tax statutes by annual Finance Acts are still needed under limited circumstances above, the length of tax provisions is the next problem

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[1209] The examples of these can be found in **Appendix IV to Chapter Five.**
[1210] TLRC, op.cit.(note1128), p.1
[1211] Morse and Williams, op.cit.(note15), p.8
[1212] The examples in **Appendix IV to Chapter Five** will elucidate this point.

to be solved. Detailed provisions are written in response to the complexity of the modern world, and are needed for legal certainty and precision[1213] and for fairness.[1214] However, they should not make tax legislation too complex, inaccessible and incomprehensible. The use of shorter sentences[1215] supplemented by a splitting technique (i.e. a detailed provision is split "into several sentences, or into subparagraphs or bullet points")[1216] will make tax law easier to read and understand.[1217]

Detailed provisions are needed under the above techniques to make legislation clear and precise. However, the TLRC says that it cannot expect the application of tax legislation "to be clear beyond doubt in all circumstances."[1218] This is because "tax legislation must deal with highly detailed and, frequently, inherently difficult subjects."[1219] It also says, "primary legislation cannot set out all the information relevant to its interpretation [;] [but] this information needs to be made available somehow."[1220] It then proposes that an explanatory memorandum for each and every clause of the annual Finance Bill should be produced[1221] and presented contemporaneously with the Bill to Parliament.[1222] Explanatory memoranda that contain explanations of the purpose of each clause of the Finance Bill, the way it would operate, worked examples and other useful details[1223] would therefore assist users understand and interpret the provisions of the law.[1224]

Style

The TLRC proposes that tax legislation should be written in "a plain English style"[1225], which involves the use of a clearer structure[1226]and avoiding the use of

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[1213] Howe, op.cit.(note1108), p.89
[1214] Baron, op.cit.(note1124), p.7
[1215] TLRC, Final Report on Tax Legislation (London: IFS, 1996), p.vii
[1216] Wallworth, op.cit.(note1120), p.413
[1217] ibid.p.413
[1218] TLRC, op.cit.(note1128), p.viii
[1219] ibid.p.viii
[1220] ibid.p.viii
[1221] The TLRC also proposes that the amount of material to be incorporated in each explanatory memorandum should be determined in the light of the nature of the legislation and the probable needs of its users. (TLRC, op.cit.(note1215), p.38) Additionally, explanatory memoranda should not be too wide that they put an enormous burden on practitioners. (ibid.38) Explanatory memoranda should be written by the Revenue' s officials and approved by Parliamentary Counsel and Ministers. (ibid.39)
[1222] ibid.pp.vii-viii
[1223] ibid.p.38
[1224] ibid.p.vii (More discussion on explanatory memoranda will be made in **subsections 4.2 and 5.7**).
[1225] ibid.p.vii

cross references.[1227] This style of drafting supplemented by a technique proposed in Wallworth (to be quoted below) is likely to make tax legislation clearer, simpler, more accessible and comprehensible.

> "Where possible, sentences should be written in the active voice (a person must pay tax) rather than the passive (tax must be paid by a person). Avoid multiple negatives – for an example, see section 78(3), Taxes Act 1988. Sentences should be written in a logical order so that the reader finds out what it is about at the beginning. Too many statutory provisions list all the exceptions before getting to the point."[1228]

Purposive drafting is another style put forward to make tax law simpler.[1229] It is also known as "general principles drafting"[1230], which can be categorized into two: "general principles without more" and "general principles with supplementary."[1231] The former relates to "the writing of legislation by reference to general concepts without any further elaboration [;] [the] detailed application of the legislation in particular cases would be left to the courts."[1232] The latter sets out "the general concepts but relies on other materials to fill in the detail."[1233]

On the above bases, general principles drafting would make primary legislation shorter and more comprehensible.[1234] This would make legislation simpler, clearer[1235], and easier for judge (and others) to construe tax statutes.[1236] The TLRC notes that there are attractions in drafting primary legislation by expressing general principles and filling in the detail through regulations.[1237] This is partly because "it would help avoid the problem of the detail obscuring the broader picture"[1238]

[1226] ibid.p.vii
[1227] TLRC, op.cit.(note1128), p.vii
[1228] Wallworth, op.cit.(note1120), p.413
[1229] Simon McKie, "Correspondance: Feedback: Purposive legislation: a road to ruin?", Taxation, 3 October 1996, p.6
[1230] TLRC, op.cit.(note1215), p.7
[1231] TLRC, op.cit.(note1128), p.27
[1232] ibid.p.27
[1233] ibid.p.27
[1234] The TLRC's Interim Report, paragraph 4.7 (ibid.p.28)
[1235] ibid.p.28
[1236] Tiley, op.cit.(note6), p.51
[1237] The TLRC's Interim Report, paragraph 4.11 (TLRC, op.cit.(note1128), p.29); and The TLRC's Final Report, paragraph 3.6 (TLRC, op.cit.(note1215), pp.7-8)
[1238] TLRC, op.cit.(note1128), p.29

However, there are at least four objections to general principles drafting, namely (a) the sacrifice of certainty, (b) insufficiently parliamentary scrutiny, (c) the complexity of regulations, and (d) the arbitrariness of tax authorities.

As regards (a), it is argued that "tax simplification [through purposive drafting] would lead to greatly increased uncertainty."[1239] This argument may be correct. This is because legal certainty requires detailed provisions (as noted above), but general principles drafting gets away from the detail. On this basis, Prebble supports the view that tax legislation should be written from a precise and detailed point of view rather than a principles and purpose point of view.[1240]

As regards (b), the TLRC expresses the view that detailed drafting may not offer certainty if it cannot be understood.[1241] Alternatively, general principles drafting would create certainty if:

(i) "the general principles expressed in the primary legislation could be elaborated by regulations;

(ii) the Revenue departments could issue guidance or authoritative notices; and

(iii) the task could be devolved to the courts." [1242]

MaKie argues against (i) and (ii) that "[purposive drafting] would simply move tax rules from statute, where they are subject to some sort of parliamentary control, to delegated legislation and Revenue memoranda where they would not be."[1243] Whilst, the TLRC proposes that a new procedure for parliamentary scrutiny of secondary legislation (regulations) would be required.[1244]

Nevertheless, in a democratic society, tax legislation should be enacted by statute, neither by secondary legislation nor by tertiary legislation (the Revenue departments' rules).[1245] Given this, regulations should not be used to elaborate the general principles expressed in tax statutes, and they should be restricted to "the

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1239 McKie, op.cit.(note1229), p.7

1240 John Prebble, "Should Tax Legislation be Written from a Principles and Purpose Point of View or a Precise and Detailed Point of View?", British Tax Review 1998 (London: Sweet&Maxwell, 1998), 113.

1241 TLRC, op.cit.(note1128), p.29

1242 ibid.p.29

1243 McKie, op.cit.(note1229), p.7

1244 TLRC, op.cit.(note1215), p.37

1245 Lagerberg, op.cit.(note1081), p.76

mechanics of administration."[1246] Additionally, the issue of the Revenue departments' guidance or authoritative notices means the transfer of power from the legislature to the executive, which is dangerous if it is not properly drafted or scrutinized.[1247]

Finally, if we produced detailed provisions by the use of shorter sentences supplemented by a splitting technique, they would be easily read and understood. Therefore, if primary legislation is written in a clear or certain form in the first place, it is not necessary to leave the task of filling in the details for obtaining the certainty to the courts.

As regards (c), many regulations to elaborate the general principles probably make tax law complex. Prebble notes that "[the US] generally adopts a briefer, more conceptual drafting style than other common law countries."[1248] Regulations are therefore required to elaborate US primary legislation. However, they are detailed and intractable.[1249]

As regards (d), it is argued that purposive drafting would lead to "tyrannical Revenue power."[1250] This argument may be correct if it leaves the detail to be filled in by administrative rulings. In this situation, "if the principle or application is unclear, 'purposive legislation' becomes 'what the Revenue tells you it means'."[1251]

According to the TLRC, purposive legislation may include the use of purposive statements involving "prefacing each part, chapter or section of the Act with a summary of what the detailed legislation which follows is designed to achieve."[1252] Statements of purpose make tax legislation clearer since they are used to supplement detailed provisions by explaining "as much *why* a section or chapter has been enacted as *how* it operates."[1253] As they can identify the legislative purpose, they will help the courts to apply a purposive interpretation of tax statutes.[1254]

1246 ibid.p.76
1247 Anthony Davis, "Purposive Drafting: Not A Panacea", The Tax Journal, Issue 465, Monday, 17 August 1998, p.12
1248 Prebble, op.cit.(note1240), p.113
1249 ibid.p.113
1250 McKie, op.cit.(note1229), p.7
1251 Malcolm Gammie, "Why is tax law complex", Taxation, 9 November 1995, p.136
1252 TLRC, op.cit.(note1128), p.27
1253 TLRC, op.cit.(note1215), p.10
1254 This point will be discussed in **subsections 5.6 and 5.7**.

Furthermore, "in the case of anti-avoidance legislation, purpose statements could help greatly because they should enshrine the intention behind it, and hopefully its scope, in clear and legally effective form."[1255] However, "introducing a 'purpose' test on top of whatever specific conditions the legislation envisages would create more uncertainty over the treatment of a transaction."[1256] It is therefore proposed that "statements of purpose will need to be drafted very carefully so as not to leave either conflicts with the detailed provisions or ambiguity as to their scope."[1257]

Tax Law Rewrite Project

Section 160, the Finance Act 1995 required the Revenue to report to Parliament on tax simplification.[1258] The Revenue presented to Parliament a report - The Path to Tax Simplification - together with a background paper in December 1995.[1259] The report has led to a project to rewrite some 6,000 pages of UK primary direct tax legislation over a period of five years.[1260] The Project aims to rewrite such legislation to make it clearer and easier to use without changing its legal effect.[1261] The CA 2001 was the first rewritten legislation produced by the Project. The ITEPA 2003, PAYE Regulations 2003, and the ITTOIA 2005 are the subsequent works by the Project so far.[1262]

Here, I will examine whether the Project has rewritten and improved existing legislation clearer and easier to use in terms of (i) the language, (ii) the length of sentence, and (iii) drafting style.

Regarding (i) and (ii), the Project uses (a) colloquial English where possible, (b) shorter sentences, and (c) modern words or words that have a well-understood meaning in place of archaic words by not changing the law.[1263] These techniques are consistent with those which I discussed previously.

[1255] Davis, op.cit.(note1247), p.12
[1256] ibid.p.12
[1257] TLRC, op.cit.(note1215), p.10
[1258] Wallworth, op.cit.(note1120), p.411
[1259] Tiley, op.cit.(note6), p.50; and HMRC, Tax Law Rewrite – Part 2: Main features of the Tax Law Rewrite project, http://www.hmrc.gov.uk/rewrite/plans0304/0304_pt2.htm, as of 24/04/2006, 1.
[1260] Howe, op.cit.(note1108), p.97
The "five years" has long expired.
[1261] HMRC, Inland Revenue Tax Law Rewrite,
http://www.hmrc.gov.uk/rewrite/background.htm, as of 24/04/2006, 1.
[1262] More details of background, operation, works and problems of the Project and the enactment of the Project' s works (Rewrite Bills) can be found in **Appendix V to Chapter Five.**
[1263] HMRC, Appendix B – Rewrite Techniques,

For example, the ITEPA 2003 replaces "the rather antiquated term 'emoluments' with 'earnings', a word which has more immediate relevance to employees and employers."[1264] The ITEPA 2003 also replaces "the equally antiquated phrase 'perquisites and profits whatsoever' with 'any gratuity or other profit or incidental benefit of any kind obtained by the employee'."[1265]

The above is likely to weaken Southern's argument against plain English techniques. As he says, "it is impossible to change the language of law without also changing its substance."[1266] Southern also says that "legislative language has to convey exact shades of meaning, and this may not be possible if the draftsman has to confine himself to 'the most plain and simple terms'."[1267] Therefore, I agree with the TLRC when it proposes that "wherever possible, words and phrases which have been judicially interpreted should be retained."[1268]

In terms of drafting style, the Project also uses similar techniques to those which I discussed previously. The Project adopts "sentences in the active, rather than passive, voice."[1269] The Project "[harmonises] definitions across the Acts where possible, and then [makes] it easier for the reader to find defined terms."[1270] The Project avoids the use of cross references by grouping "similar rules together in one place."[1271]

Additionally, the Project rewrites existing legislation with a more logical and clearer structure.[1272] For example, "[the ITEPA 2003] reorganises and redrafts the material relating to share schemes and share option schemes which was developed in consultation with share scheme practitioners, who confirm that the provisions are indeed clearer and easier to understand."[1273] And "[the ITEPA 2003] draws together all the provisions charging benefits to tax into a coherent code."[1274]

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http://www.hmrc.gov.uk/rewrite/plans0304/appendix_b.htm, as of 24/04/2006, 1.

[1264] HMRC, Tax Law Rewrite – Part 3: What we achieved in 2002/2003, http://www.hmrc.gov.uk/rewrite/plans0304/0304_pt3.htm, as of 24/04/2006, 1.

[1265] ibid.p.1

[1266] David Southern, 'Big-Endians' v 'Little-Endians', Taxation, 16 October 1997, p.56

[1267] ibid.p.57

[1268] TLRC, op.cit.(note1215), p.31

[1269] HMRC, op.cit.(note1263), p.1

[1270] ibid.p.1

[1271] ibid.p.1

[1272] HMRC, op.cit.(note1259), p.1

[1273] HMRC, op.cit.(note1264), p.1

[1274] ibid.p.1

Also, the CA 2001 is easier to follow because it has a logical structure. As Parry-Wingfield says, "it will be in one piece rather than strung all over the place, and this is a matter not just of consolidating the provisions from the various Acts but of restructuring the topic from first principles."[1275] Morse and Williams also say, "the exacting work [has been] undertaken [by the Project] to ensure that a logical structure emerges where possible [;] [for] example, many provisions are listed in the order of practical importance."[1276]

Furthermore, the Project has used "a new format and layout to make it easier to read"[1277], made "greater use of signposts to guide the reader to other relevant provisions"[1278], made minor changes to improve the rewritten legislation[1279], and removed obsolete provisions.[1280] Moreover, the Project has produced explanatory notes to help users to understand and interpret the rewritten legislation.[1281]

It is probable that the rewritten legislation (after the completion of the Project's work) will contain more than 6,000 pages.[1282] Despite this, the Project has made the legislation clearer and easier to read and understand. The Budd Committee Report supports the view that:

> "The benefit of this Project in terms of clearer and more user-friendly legislation is apparent from [the CA 2001] and [the ITEPA 2003]. The benefits of its work can also be seen in its influence on the drafting style of many Finance Bill measures."[1283]

Nevertheless, some scholars do not think that the rewritten legislation can remove the real cause of legal complexity.[1284] This is because the Project does not

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1275 Maurice Parry-Wingfield, "A Milestone For The Rewrite", The Tax Journal, Issue 558, Monday, 24 July 2000, p.20

1276 Morse and Williams, op.cit.(note15), p.52

1277 HMRC, op.cit.(note1259), p.1

1278 HMRC, op.cit.(note1263), p.1

1279 HMRC, op.cit.(note1259), p.1

1280 ibid.p.1

1281 HMRC, op.cit.(note1264), p.2

1282 This is partly because extra statutory concessions have been legislated; and more modern words and expressions as well as the splitting technique have been used.

1283 TLRC, op.cit.(note1112), p.2 Others also comment that the Project improves tax legislation, which can be found in **Appendix VI to Chapter 5**. The table of comparison between certain provisions of the current legislation and those of the rewritten legislation in **Appendix VII to Chapter 5** will also prove this point.

1284 John Avery Jones, "Tax Law: Rules or Principles?", Fiscal Studies (1996) Vol.17, No.3, p.66; David Martin, "Guest Editorial", The Tax Journal, Issue 451, 11 May 1998, p.2; and Chris Reece, "The Best of all Possible Worlds", The Tax Journal, Issue 530, Monday 10 January 2000, p.3

change the underlying tax policy.[1285] Tax policy adds to legal complexity.[1286] However, as noted earlier, simpler policy leads to simpler legislation.[1287] Given this, if the Project rewrote existing legislation from the simpler policy, the Project would solve legal complexity. The TLRC supports the view that "complexity does not only derive from the way the legislation is expressed and that without policy changes the benefits from rewriting existing legislation are not maximised."[1288]

However, the TLRC notes that "[the Project] would achieve nothing if it tried to change both language and policy."[1289] This is because "it could lead to an undesirable blurring of [the Project's] purpose and sidetrack it from its primary purpose of producing clearer legislation."[1290] Meanwhile, the Project recognizes a change in tax policy, but this is outside the Project' s responsibility.[1291] Tax policy is a political problem.[1292] Reece recommends that tax law will be simple if politicians have been forced to limit the use of tax policy.[1293]

As a result of the policy constraints, the Project cannot remove legal complexity stemming from complex tax policy. It is therefore recommended that another project should be established to help the Rewrite Project to review and propose changes in the underlying tax policy for tax simplification.[1294] As the Budd Committee Report says,

> "There should be established a Tax Structure Review Project (TSRP) as a parallel Project complementing the Tax Law Rewrite Project (TLRP). The TSRP would have a remit to review current tax legislation free of the policy constraints imposed on the TLRP and in particular from the perspective of seeing what can be done to simplify the tax system. As such, it should act as a constant reminder within government of the need for tax simplification."[1295]

1285 Parry-Wingfield, op.cit.(note1275), p.17
1286 TLRC, op.cit.(note1128), p.22
1287 ibid.p.1
1288 TLRC, op.cit.(note1215), p.40
1289 ibid.p.40
1290 TLRC, op.cit.(note1112), p.13
1291 HMRC, Tax Law Rewrite – Main features of the Tax Law Rewrite project, http://www.hmrc.gov.uk/rewrite/plans0001/0001_pt2.htm, as of 14/02/2006, 4.
1292 McKie, op.cit.(note1229), p.7
1293 Reece, op.cit.(noe1284), p.3
1294 The Budd Committee Report, paragraphs 7.4, 7.6, 7.7 and 8.4 (TLRC, op.cit.(note1225), pp.13-15)
1295 ibid.p.2

Lord Howe also says,

"[The TSRP] must be able, 'to put forward proposals for tax law reform and simplification'. But it must be able to do more than just propose. It must have, in Adam Broke's most recent prescription, some guaranteed 'ability to get Ministers to promote the change it recommends'."[1296]

In doing so and in reviewing and making recommendations as to rewriting existing legislation, the TSRP should take into account the idea of optimal tax structures and the criteria of making changes to tax statutes where inevitable and necessary (as proposed earlier). This would help simplify tax legislation.

3.2.2.3 Solutions to the problems arising from consolidation

As noted in 3.1.2, UK tax law is lacking in structure. The system of consolidation has been adopted to solve this difficulty. However, consolidation Acts lead to (a) inconsistency of language and structure, (b) problems of interpretation, and (c) inconvenience to learn new section numbers and a new structure.

As regards (a) and (b), these can be solved by rewriting existing legislation with a more logical and clearer structure, and with modern and well-understood words under the Rewrite Project.[1297] This will save the time for users of tax law not only to find all the law dealing with a particular tax but also to understand its meaning. This can solve the problems raised by the TLRC: "So the reality is not that users of tax legislation want that legislation to be as short as possible but that they need to be able to comprehend it in the shortest time possible."[1298]

As regards (c), this can also be solved by the rewritten legislation under the Rewrite Project. As Wyatt notes,

"The proposed tax rewrite provides the opportunity for designing the new legislation in such way that the need for a future consolidating Act is deferred for a much longer time than would be available under the present system."[1299]

Wyatt also recommends that "every time an entirely new tax is introduced, it should be set out in its own separate Act [;] ..... [this] separate Act would itself be

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[1296] ibid.p.13

[1297] Gammie supports the view that "drawing existing legislation into a re-written Code could provide a clearer, more coherent structure to what we have at present." (Gammie, op.cit.(note1251), p.137)

[1298] TLRC, op.cit.(note1128), p.4

designed for longevity, with the aim of not needing to be consolidated for at least 50 years."[1300]

As we saw, there are now three separate Acts under the Project, i.e. the CA 2001, the ITEPA 2003, and the ITTOIA 2005. There will be Bill 4 to complete the Project's work on income tax and Bill 5 (Corporation Tax Bill).[1301] If separate Acts under the Project could defer future consolidation for a longer time, this would solve inconvenience to learn new section numbers and a new structure stemming from the frequent consolidation legislation.

A separate Act is "a single of body of law for future amendment."[1302] Therefore, if there were amendments to and new sections inserted into a separate Act by annual Finance Acts, all the changes might be fit into a separate Act immediately after changes, instead of waiting for consolidation. This way seems to adopt the system of codification into the system of UK tax law. As discussed earlier, codification satisfies simplicity and certainty, reducing confusion and difficulty in the application of tax law. In Australia and the United States which adopt codification, individual Finance Acts need not be consulted once they have amended a single taxing statute.[1303]

However, the disadvantage of codification is that "practitioners in Australia can find that they have to refer to section 159GZZZZA(2)(*b*)(*iii*)(B), Income Tax Assessment Act 1936."[1304] This might not be a serious problem for separate Acts under the Rewrite Project or for other future Acts of Parliament if:

(a) each Act were designed for longevity,
(b) a set of tax provisions and a numbering system in each Act were well-organized, and
(c) changes to existing legislation were made where clearly inevitable and necessary.

1299 Wyatt, op.cit.(note1137), p.302
1300 ibid.p.302
1301 HMRC, Consultation Papers, Exposure Drafts and Response Documents, http://www.hmrc.gov.uk/rewrite/exposure/menu.htm, as of 25/05/2006, 1-2.
1302 Gammie, op.cit.(note1251), p.137
1303 Wallworth,op.cit.(note1120), p.413
1304 ibid.p.413

4. Delegated legislation

4.1 Features, advantages and disadvantages

Another main source of Thai and UK tax laws is delegated legislation. Theoretically, any taxing Act may lack the detailed and technical rules necessary for its operation. To resolve this problem, an Act may empower administrative bodies to make orders or regulations relating to the detailed and technical rules without the enactment of another Act.

Orders or regulations made by administrative bodies are known as 'delegated' or 'secondary' legislation; meanwhile an enabling Act is known as the 'Parent Act.'[1305] Delegated legislation is subject to the doctrine of *ultra vires*, i.e. its content cannot go beyond the conferring provision in the Parent Act (if it goes beyond "it is invalid and further legislation is required.")[1306]

According to the Thai Constitution, administrative bodies will make delegated legislation only when there are provisions in the Parent Act conferring powers upon them. Additionally, delegated legislation must be of general application and not intended to apply to any specific case or person.[1307] Thai taxing Acts empower administrative bodies to make delegated legislation, which includes Royal Decree, and Ministerial Regulations.

Meanwhile, UK taxing Acts also empower administrative bodies to make delegated legislation by means of statutory instrument.[1308] Delegated legislation is used in direct tax, and more extensively used in indirect tax.[1309] The objective of UK delegated legislation is "to amend or extend [primary legislation] as [government departments think] necessary."[1310] For instance, "delegated legislation is used in the direct tax field to give practical administrative effect to particular proposals, for example the PAYE system."[1311]

1305 Elizabeth A. Martin, ed., Oxford Dictionary of Law, 4th ed. (Oxford: Oxford University Press, 1997) p.134

1306 Simon's Direct Tax Service:Binder 2, op.cit.(note79), p.1110

1307 Paragraphs one, two and three, Section 29, the Constitution

1308 CCH Tax Handbook, op.cit.(note12), p.508

1309 TLRC, op.cit.(note1112), p.4

1310 Lymer et al., op.cit.(note120), p.1/16

1311 TLRC, op.cit.(note1112), p.5

There are four advantages of delegated legislation.

First, it can be made without taking up as much parliamentary time as primary legislation.[1312]

Secondly, it speeds up the operation of the Parent Act without passing another Act.

Thirdly, it solves the problem of the Parent Act that lacks details and technical rules for its operation.

Fourthly, since it can make changes to the Parent Act, it will help correct errors or fill gaps discovered in the Parent Act.

Nevertheless, the above advantages may be undermined by **three disadvantages.**

(1) Abundance of delegated legislation

Many pieces of delegated legislation complicate the tax legislation. In Thailand, most taxing Acts empower administrative bodies to make delegated legislation. One possible reason for this is that "Parliament is indirectly dominated by the executive branch."[1313] In 1987, there were more than 50,000 pieces of delegated legislation (including delegated legislation on tax matters).[1314] There are still many pieces of delegated legislation at present.[1315] There are over a thousand of pages of UK statutory instruments as well.[1316]

(2) Confusion and non-transparency in tax legislation

Many pieces of Thai delegated legislation dealing with a particular tax cause confusion to taxpayers. As Hummel and Sethsathira note, "there are also hundreds of [delegated legislation]... [;] [it] is little wonder then that foreign investors find themselves totally confused with the tax laws, because even their local counterparts are also confused."[1317]

1312 Martin, op.cit.(note1305), p.134

1313 Borwornsak Uwanno and Surakiart Sathirathai, "Introduction to the Thai Legal System", Legal Systems in the ASEAN Region (Bangkok: Amarin Printing Group, 1987), 82.

1314 ibid.p.82

1315 Thongprakam, op.cit.(note178), p.50

1316 Tiley, op.cit.(note6), p.51

1317 Anita Louise Hummel and Pises Sethsathira, Starting and Operating a Business in Thailand (Singapore: McGraw-Hill Book Co-Singapore, 1991), 155.

Additionally, the steadily increasing provisions of delegated legislation make the tax system less transparent[1318] and complex. Such confusion, non-transparency and complexity go against the criteria of certainty and simplicity.

One notes that "[finance] legislation in recent times increasingly contains provisions which empower administrative bodies to make 'secondary' legislation."[1319]The increasing quantity of UK statutory instrument probably causes legal complexity and confusion to British taxpayers.

(3) Lack of scrutiny

UK statutory instruments on tax matters have not been examined by parliamentary procedures like an Act. One notes, "most statutory instruments which deal with taxation must be laid before the House of Commons only and are considered by the Commons Select Committee on Statutory Instruments."[1320] Nevertheless, "the [finance] legislation provides for control of statutory instruments by Parliament by either requiring approval of the draft by the House of Commons before they are made or by making them subject to annulment by resolution of the House of Commons (or either House)."[1321]

Unlike in the UK, the RCT and the Thai Constitution do not require delegated legislation to be laid before the House of Representatives or the Senate, and have no provision for control of delegated legislation by Parliament. Therefore, there is no parliamentary scrutiny of Thai delegated legislation. Some Thai delegated legislation deals with technical rules for supplementing the operation of taxing Acts which, I think, need not be subject to parliamentary scrutiny. Meanwhile, others deal with important tax matters which, I think, must be subject to parliamentary scrutiny.

The RCT empowers administrative bodies to make delegated legislation to deal with the main structures of the PIT, such as granting reduction of tax rates or tax exemption[1322], determining the deduction of expenses for PIT purposes[1323], and

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[1318] Dhiratayakinant, op.cit.(note605), pp.1.1-24
[1319] CCH Tax Handbook, op.cit.(note12), p.508
[1320] Simon's Direct Tax Service:Binder 2, op.cit.(note79), p.1110
[1321] CCH Tax Handbook , op.cit.(note12), p.508
[1322] Section 3, RCT
[1323] Sections 43, 44, 45, and 46, RCT

determining the exclusion of income from the PIT.[1324] From my standpoint, these important tax matters should be subject to parliamentary scrutiny.

4.2 Improvements in delegated legislation in both countries

Taxation is a function of the public sector interfering with people's rights and freedom in using their property. Therefore, the consent of all people of a country through the legislative process by Parliament where consists of people's representatives must first be obtained before taxes are imposed on people.[1325] In other words, all major tax rules/matters should be subject to political debate and proper parliamentary scrutiny.

As noted above, Thai delegated legislation does not receive parliamentary scrutiny, and some of which have been made to deal with the main structures of the PIT. Tax rate reduction, tax exemption, deductible expenses and income exclusion are related to restrictions on people's rights and liberties in the use of their resources and on the removal of certain people from tax. These major tax matters should therefore be scrutinized under parliamentary procedures, as this represents the consent of all citizens.

Therefore, the scope of delegated legislation should not extend to the major tax matters which include changes in tax rates, tax bands, tax reliefs, tax credits, tax exemptions, tax abolition, deductible expenses, income exclusion, and the imposition of new taxes. Its function should be limited only to stipulate technical rules (to supplement the operation of taxing Acts, such as methods, conditions, guidelines or directions for tax administration and tax collection).

The Budd Committee Report notes that "regulation has been resorted to in recent years to deal with a number of highly complex and detailed direct tax provisions and power is taken more often than has previously been the case to amend particular aspects of certain direct tax regimes."[1326] However, statutory instruments are not subject to the same parliamentary as Acts of Parliament. Therefore, the scope

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[1324] Sections 4 and 42 (17), RCT

[1325] This argument is widely supported. For example, Maas says, "taxation is a necessary evil [;] [but} it should not be imposed on the citizenry from outside; it need to be sanctioned by their elected representatives." (Maas, op.cit.(note1089), p.10)

[1326] TLRC, op.cit.(note1112), p.5

of UK statutory instruments should not extend to the important tax matters which should be dealt with by taxing Acts, and be limited only to technical rules.

From the above, the limitation of scope of Thai and UK delegated legislation would reduce the amount and steady increase in provisions of delegated legislation. This would reduce legal complexity and confusion, and increase transparency in the Thai and UK tax system.

If the expressions in delegated legislation/statutory instruments were plain, unambiguous, straightforward, and consistent, this would also help make delegated legislation/statutory instruments less complex, clearer, more accessible and comprehensible. To do so, the provisions in delegated legislation/statutory instruments should be written from a detailed viewpoint, and not be written in a convoluted style and too tight, nor contain jargon and archaic words and very long sentences.

Finally, the TLRC proposes that "explanatory memoranda should be provided for secondary legislation on the same basic as for primary legislation."[1327] Explanatory memoranda would contain explanations of the purpose of each clause of delegated legislation, the way it would operate, worked examples and other useful details.[1328] Therefore, if Thai and UK governments adopted this proposal, explanatory memoranda would assist users of delegated legislation/statutory instruments understand and interpret the legislation, especially ambiguous expressions/words. This would reduce confusion and difficulty in applying the legislation.

5. Judicial interpretation and judicial anti-avoidance rules

5.1 Function of the courts

Brooks points out that judges have three tasks in deciding tax cases, i.e.

(a) to give meaning to the words in the statute,

(b) to characterize the taxpayer's transaction for purposes of applying the tax statute; and

[1327] TLRC, op.cit.(note1215), p.39
[1328] ibid.p.38

(c) to discourage tax avoidance.[1329]

One supports (a) that it is necessary for the courts to interpret the words in the statute "to ascertain their applicability of the facts in question."[1330] Regarding (b), Brooks suggests that

> "It would be impossible to administer a tax system fairly if the courts were bound by the legal form of the parties' transaction. If there is evidence that taxpayers do not intend to enforce the legal rights and obligations they have created, their economic position has not changed and neither should their tax liability."[1331]

In my view, when a dispute between a tax-gatherer and a taxpayer arises, the courts need to consider facts and transactions, and then to interpret the words used in the relevant tax provisions. Thereafter, they will apply what they interpret to seek whether the words are accurately applied by the taxpayer and the tax-gatherer in accordance with the intention of an enactment; and to seek whether tax is properly paid or collected.

Regarding (c), Brooks notes that "an additional responsibility of judges is to prevent income tax avoidance, when it is administratively feasible."[1332] This task of the courts (which may be considered a debatable objective) will be further discussed in 5.6. The next sections consider fundamental principles underlying judicial interpretation.

5.2 Impact of Human Rights Act 1998 ('HRA') on statutory interpretation

HRA came into effect in October 2000.[1333] HRA incorporates the provisions of the European Convention on Human Rights ('the Convention') into UK law.[1334] Such provisions, which are now set out in Schedule 1 to HRA, are those contained in the

[1329] Neil Brooks, "Chapter 3: The Responsibility of Judges in Interpreting Tax Legislation", Tax Avoidance and The Rule of Law, Graeme S. Cooper, ed., (Amsterdam: IBFD Publications BV, 1997), 94.
[1330] CCH Tax Handbook , op.cit.(note12), p.511
[1331] Brooks, op.cit.(note1329), p.96
[1332] ibid.p.96
[1333] Christopher Wallworth, "Do Taxpayers Have Human Rights?", Taxation, 15 June 2000, p.284
[1334] Thuronyi, op.cit.(note10),p.110

Convention itself and in the first and the sixth protocols.[1335] UK courts must give effect to such provisions; or must protect human rights as contained in the Convention and its protocols ('the Convention rights').

In the matter of interpretation, HRA requires UK courts and tribunals to interpret all UK primary and subordinate legislation in a way which is, so far as is possible, compatible with the Convention rights.[1336] One notes that "the onus is on the courts to provide a judicial interpretation that is in accordance with the Convention rights, even if this requires a 'strained' construction of the legislation.[1337] This means that "words can be read into statutes or omitted or given an artificial meaning."[1338]

If interpretation in accordance with the Convention rights is impossible, then the High Court and above may make a declaration of incompatibility.[1339] It is noted that "the courts have no power to declare the legislation invalid"[1340], and "the law has to be applied strictly as written."[1341] Therefore, "if in a particular case, the UK legislation cannot be read in a way that is compatible with the Convention rights, then the UK legislation will prevail over the Convention."[1342] It is also noted that:

> "The court may issue a declaration of incompatibility, but it is up to the Government to choose whether or not to amend the offending legislation; and the Government is under no obligation to do so. In the event that the Government does not introduce curative legislation, then the aggrieved party may still apply to [the European Court of Human Rights (the ECtHR)] for relief."[1343]

HRA also requires that in interpreting UK legislation in accordance with Convention rights, courts and tribunals must take account of relevant judgments, decisions, declarations and opinions of the ECtHR and the European Commission on

[1335] The provisions that are likely to be most relating to tax matters can be found in **Appendix VIII to Chapter Five**.
[1336] Section 3(1), HRA 1988
[1337] Simon's Direct Tax Service:Binder2, op.cit.(note79), p.1605
[1338] ibid.p.1605
[1339] Section 4, HRA 1988
[1340] Wallworth, op.cit.(note1333), p.284
[1341] ibid.p.284
[1342] Simon's Direct Tax Service:Binder2, op.cit.(note79), pp.1605-1606
[1343] ibid.p.1606

Human Rights (the EComHR), so far as, they are relevant to the issues in the proceedings.[1344]

The above rules apply to the interpretation of UK tax legislation. When the UK courts apply such rules, they may or may not make a declaration of incompatibility.

Example of no declaration of incompatibility[1345]

In *R (on the application of Professional Contractors Group Ltd) v IRC*[1346], the Administrative Court did not declare that IR35 legislation[1347] (the provisions in the Finance Act 2000) was incompatible with the right under Article 1 of the First Protocol. This right is directly relevant to tax legislation, i.e. the right of a natural or legal person to the peaceful enjoyment of his possessions. However, under paragraph 2 of this article, this right will not impair the right of the state to secure the payment of taxes.

Wallworth refers to the EComHR that "taxation is not compatible with the First Protocol if it amounts to confiscation of the taxpayer's possessions."[1348] When the Court considered that IR35 legislation "was not even arguably so severe as to amount to a *de facto* confiscation of property, to fundamental interference with a person's financial position or to an abuse of the [UK's] right to levy tax"[1349], it did not declare that IR35 legislation breached a Convention right.

Example of declaration of incompatibility

In *R (on the application of Wilkinson) v IRC*[1350], W contended that section 262 (1), TA 1988, which granted widow's bereavement allowance to widows but refused to provide an equivalent income tax reduction to widowers in identical circumstances on grounds of gender, breached Article 14 of the Convention read with Article 1 of the First Protocol. Article 14 provided that the enjoyment of the rights and freedoms set out in the Convention were to be secured without

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[1344] Section 2, HRA 1988
[1345] More examples can be found in **Appendix IX to Chapter Five.**
[1346] [2001]STC629
[1347] Under IR35, individuals who provided services to clients through 'service companies' were taxed.
[1348] Wallworth, op.cit.(note1333), p.284
[1349] [2001]STC629at630
[1350] [2002]STC347

discrimination on the grounds such as, *inter alia*, sex or other status. W was given a declaration of incompatibility. [1351] As the Administrative Court declared that:

> "The refusal to grant a tax reduction to men in a similar situation to women was a breach of art 14 read with art 1 of the First Protocol in the absence of any objective justification advanced for such discrimination."[1352]

However, according to the decision of the Court of Appeal[1353], "there was no obligation on the Revenue to grant an extra statutory concession to correct discrimination under the tax legislation."[1354] The provision in question is now repealed.[1355]

Finally, it should be noted that "the question as to which bits of tax legislation are vulnerable to being declared incompatible with the [Convention] is still an open one."[1356]

5.3 Judicial interpretation and simplicity and certainty

It is argued that case law helps make the tax system complex.[1357] However, I do not entirely agree with this argument. In case where tax provisions are unclear, judicial interpretation provides the principles and concepts to make such provisions clear. This further makes the tax system less complex. Whitehouse *et al.* give an example to support this point as follows:

> "Many concepts are not defined by [UK] statute (what is a trade? what is an income receipt/expense?), many provisions are obscure, and it is the role of the judiciary to resolve such difficulties and of case law to fill the gaps."[1358]

Additionally, a strict interpretation will ensure certainty in the operation of tax legislation. In contrast, if the courts fail to interpret tax legislation and provide principles/concepts in the case of ambiguity and to apply a strict interpretation, the problems of complexity and obscurity will still exist in the system of tax law.

1351 However, W was not given compensation. He would have had to apply to the ECtHR for compensation. (Collision and Tiley, op.cit.(note1111), p.33)
1352 [2002]STC347at348
1353 [2003]STC1113
1354 Collision and Tiley, op.cit.(note1111),p.33
1355 ibid.p.33
1356 ibid.p.30
1357 Lymer, et al., op.cit.(note120), p.1/16
1358 Whitehouse, et al., op.cit.(note549), p.36

5.4 Strict interpretation

This approach will ensure legal certainty. A strict interpretation means that the meaning of expressions/words is given according to the language of the statute regardless of any intendment. Under this approach, the tax statute must be clearly worded. Therefore, people can foresee whether they are or are not liable to tax.

In most cases, the Thai courts have stuck to a strict interpretation. For example, in *the Revenue Department* v. *Mrs. Valai or Jitapa Kaithamjittakul*[1359], the Supreme Court held that:

> "The Revenue Code is the public law that stipulates the people's obligations to the State. This law affects the rights, liberties, and properties of the people. Hence, the Revenue Code must be strictly interpreted in such a way that the taxpayers' obligations are not increased or their rights are not too greatly affected...."

It has been found that "for a long time, judicial thinking [in the UK] was that tax laws should be interpreted strictly."[1360] For example, Lord Cairns LC said in *Peyce* v. *Monmouthshire Canal and Railway Company*[1361] that "Taxing Acts are to be construed with strictness." Rowlatt J. laid down the rule in *Cape Brandy Syndicate* v. *IRC*[1362] that:

> "....in taxation you have to look simply at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. You read nothing in, you imply nothing, but you look fairly at what is said and what is said clearly and that is the tax."

In *Tennant* v. *Smith*[1363] Lord Halsbury L.C quoted the statements of Lord Wensleydale in *In re Micklethwait*[1364] that:

> "It is a well-established rule, that the subject is not to be taxed without clear words for that purpose; and also, that every Act of Parliament must be read according to the natural construction of its words."

1359 The Supreme Court's decision No.1908/2538
1360 Morse and Williams, op.cit.(note15), p.39
1361 [1878-1879]4App.Cas.197at202-203
1362 [1921]12TC358at366
1363 [1892]AC150at154
1364 11 Ex. at 456

The Thai and the British courts have interpreted tax provisions in favour of taxpayers in the case of ambiguity. For example, in *S-Jun advertising juristic partnership* v *Bangkok Metropolis*[1365], the Supreme Court held that "where the legislation is obscure, it must be strictly interpreted in a way that is not against the taxpayer." Lord Simon said in *Customs and Excise* v. *Thorn Electrical Industries Ltd*[1366] that "You cannot tax on an ambiguity." Lord Wiberforce confirmed in *Inland Revenue Comrs* v. *Joiner*[1367] that "... clear words are required to impose a tax, so that the taxpayer has the benefit of doubts or ambiguities [whether a tax has been imposed on them.]" However, a taxpayer is not favoured in the case of ambiguity in the exception from taxation given by the statute because the exception must be interpreted with strictness.[1368]

5.5 Material used in the case of ambiguity

Lord Halsbury said in *IRC v Priestley*[1369] "the Act must be read as a whole [;] where there is an ambiguity the scheme of the Act may resolve it." Additionally, the British courts can look at parliamentary material in limited situations, for example, the clear statements by a Minister during proceedings or debates in Parliament, in seeking Parliament's intention where legislation is ambiguous or obscure, or lead to an absurdity. This derives from the rule in *Pepper* v. *Hart.*[1370]

The use of parliamentary material in interpreting ambiguous words helps make such provisions clear. However, this aid is unlikely to be sufficient to encourage legal certainty. This is because words in tax provisions have both a technical meaning and an ordinary meaning. There should be other aids than parliamentary material in helping construe ambiguous words. This point will be further discussed in 5.7.

There is no authority to allow the Thai courts to use parliamentary material as guidance on the interpretation of tax statutes.

1365 The Supreme Court's decision No.2317/2519
1366 [1975]STC617at 620
1367 [1975]STC657at 662
1368 Per Cohen LJ in *Littman* v. *Barron* [1951]33TC373at386
1369 [1901]AC208at213
1370 [1992]STC899

5.6 Purposive interpretation

This approach is the interpretation of the legislation by reference to Parliament's intention.[1371] The UK courts are increasingly adopting this approach because strict interpretation leads to tax avoidance. However, whilst a strict interpretation ensures legal certainty, a purposive interpretation cannot ensure certainty.

A strict interpretation provokes tax avoidance under the following conditions:

(a) the taxpayer arranges his/her transaction within the wording of the relevant statute;

(b) the courts only consider the legal form of the transaction, regardless of its economic substance;

(c) the courts have regard only to what is clearly said in the statute, without reference to legislative intention; and

(d) therefore, if the transaction which is artificial falls outside the extend of a charging provision or within the scope of a statutory provision governing favorable tax treatment, the taxpayer will obtain a tax advantage.

Under the above conditions, the taxpayer can structure a transaction in such a way that he/she will pay less tax or pay no tax. Similarly, tax avoidance is approved under the combination of literalism and formalism.[1372] The arrangement of the taxpayer's transaction to reduce his/her tax liability under the above conditions is recognized by the UK courts since the *Duke of Westminster's* case (1936) until the mid-1980s.[1373] In the *Westminster* case[1374], Lord Tomlin said, "every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."[1375]

In this case, the court applied a strict interpretation. As Lord Russell said, "the subject is not taxable by inference or analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case."[1376] Additionally, this case showed that the court did not look beyond the legal form of the transaction to its economic substance. Parsons as referred to in Cooper calls this style of interpretation

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[1371] TLRC, op.cit.(note1215), p.10
[1372] TLRC, op.cit.(note7), p.10
[1373] Thuronyi, op.cit.(note10), p.152
[1374] [1936]19TC490
[1375] [1936]19TCat p.520
[1376] [1936]19TCat p.524

"form and blinkers" – "judges confining themselves to examining only the form in which a transaction is cast, examining only the legally enforceable elements of that form, and treating that form as determinative."[1377]

The combination of strict interpretation and the doctrine of form leads to tax avoidance, resulting in injustice/inequity (because some people could avoid paying tax whereas others could not), erodes public revenues, and adversely affects income redistribution (because rich people receive the most benefit). To strike down tax-avoidance schemes, certain judges are prepared "look beyond the words to the underlying purpose and beyond the form of the transaction to its substance."[1378] Likewise, the courts have tried to depart from the strict approach, and to adopt the purposive approach. This new approach is sometimes known as "a judge-made rule."[1379]

The landmark case as to the new approach is *Ramsay Ltd* v. *IRC.*[1380] In this case, the House of Lords combated a tax-avoidance scheme on the basis that "it was entitled to look at the overall result of several transactions and need not give tax effect to every single transaction."[1381] Lord Wilberforce stated,

> "It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax, or a tax consequence, and if that emerges from a series, or combination of transactions, intended to operate as such, it is that series or combination which may be regarded."[1382]

The approach or the court's task, according to Lord Wilberforce, has been criticised in that "it appears to prefer judge-made law over the expressed intentions of Parliament."[1383] It is also argued that the courts "are denying the literal interpretation and corresponding application of statutes to transactions which, as a matter of fact, have been found to exist."[1384]

[1377]Graeme Cooper, op.cit.(note95), p.24
[1378] Chamberlain, et al.,op.cit.(note78), p.9
[1379] Thuronyi, op.cit.(note10), p.151
[1380] [1982]AC300
[1381] Frans Vanistendael, "Chapter 4: Judicial Interpretation and the Role of Anti-Abuse Provisions in Tax Law", Tax Avoidance and The Rule of Law, Graeme S. Cooper, ed., (Amsterdam: IBFD Publications BV, 1997), 139.
[1382] [1982]AC300at 323-24
[1383] Tookey, op.cit.(note1), p.368
[1384] ibid.p.368

The *Ramsay* principle was developed by *Furniss* v. *Dawson.*[1385] In this case, Lord Fraser interpreted the *Ramsay* principle as being that "the fiscal consequences of a preordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately."[1386] In addition, Lord Brightman described the criteria for the application of the *Ramsay* principle as follows:

- there must be a pre-ordained series of transactions (or single composite transaction),
- there must be any artificial steps inserted in the series of transactions with no commercial (business) purpose other than a tax advantage,
- if the above ingredients exist, the court must disregard the inserted steps and look at the end result of the transactions (to determine its true legal effect), and tax the end result by relating it to the relevant taxing provisions.[1387]

Lord Brightman's formulation is sometimes known as the "step transaction" doctrine and the "commercial purpose" doctrine.[1388] Orow notes that "this formulation has been adopted and applied by a number of subsequent decisions."[1389] Chamberlain, *et al.* note that:

> "Apart from illustrating that in certain circumstances it is the substance of the transaction which determines whether or not tax is chargeable, the [*Dawson*] case also showed an acceptance by the House of Lords that the courts can and should bolster taxing statutes with judge-made law."[1390]

Nevertheless, the scope of the step transaction doctrine is limited by the House of Lords in *Craven v. White.*[1391] Collision and Tiley note that the decision in

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[1385] [1984]STC153
[1386] [1984]AC474at512
[1387] [1984]STC153at159
[1388] Vanistendael, op.cit.(note1381), p.140
[1389] Nabil Orow, "Structured Finance and the Operation of General Anti-Avoidance Rules", British Tax Review 2004 (London: Sweet&Maxwell, 2004),418.
[1390] Chamberlain, et al., op.cit.(note78), p.9
[1391] [1988]STC476

this case "rejects any possible wide scope of the New Approach in favour of a narrowly defined step transaction doctrine."[1392] In this case, Lord Oliver said,

> "Every case has to be determined on its own facts and every series of transactions has to be examined and analysed to determined whether in truth, it constitutes a single composite and integrated whole entitling the court, in construing the statute, to ignore the legal effect of individual steps because they are not and never were contemplated as other than part of a single whole."[1393]

Lord Oliver also described that in interpreting tax legislation, the courts have to ascertain that "what is the relevant transaction or combination", before they construe and apply "the statutory formula" to it.[1394] He disagreed with the rule of judge-made law because "judges are not legislators." [1395] Lord Jauncey supported that "it does not entitle the court to legislate at large against specific acts of tax avoidance where Parliament has not done so."[1396]

Tiley notes that "the first modern tax case where a majority of the House of Lords came out in favour of the purposive approach was *McGuckian v IRC* [1397] in 1997."[1398] In this case, Lord Steyn said, "where there is no obvious meaning of a statutory provision the modern emphasis is on a contextual approach designed to identify the purpose of a statute and to give effect to it."[1399] He also stated that the following statement made by Lord Wilberforce in the *Ramsay* case had marked "the rejection by the House of pure literalism in the interpretation of tax statutes"[1400] :

> "A subject is only to be taxed upon clear words, not on 'intendment' or on the 'equity' of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle. What are 'clear words' is to be ascertained on normal principles; these do not confine the courts to literal interpretation.

1392 Collision and Tiley, op.cit.(note1111), p.179
1393 [1988]STC476at500
1394 [1988]STC476at499
1395 [1988]STC476at497
1396 [1988]STC476at522
1397 [1997]STC908
1398 Tiley, op.cit.(note6), pp.56-57
1399 [1997]STC908at915
1400 [1997]STC908at916

There may, indeed should be, considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should be regarded."[1401]

Lord Steyn continued to explain that "the [*Ramsay*] principle was developed as a matter of statutory construction … [;] [it] was not based on a linguistic analysis of the meaning of particular words in a statute [;] [it] was founded on a broad purposive interpretation, giving effect to the intention of Parliament."[1402] Lord Cooke supported a purposive interpretation that "….in determining the natural meaning of particular expressions [in the context of taxing Acts], weight is given to the purpose and spirit of the legislation."[1403]

In *Macniven v Westmoreland Investments Ltd*[1404], the House of Lords limited the scope of the *Ramsay* principle.[1405] Lord Nicholls said,

"The need to consider a document or transaction in its proper context, and the need to adopt a purposive approach when construing taxation legislation, are principles of general application. Where this leads depends upon the particular set of facts and the particular statute."[1406]

In this case, Lord Hoffmann said that one principle of construction is "to ascertain what Parliament meant by using the language of the statute."[1407] He also described Lord Brightman's formulation in *Dawson*[1408]as "a careful and accurate summary of the effect which the *Ramsay* construction of a statutory concept had upon the way the courts will decide whether a transaction falls within that concept."[1409] He continued,

"If the statutory language is construed as referring to a commercial concept, then it follows that steps which have no commercial purpose but which have been artificially inserted for tax purposes into a composite transaction will not affect the answer to the statutory question."[1410]

1401 [1982]AC300at323
1402 [1997]STC908at916
1403 [1997]STC908at920
1404 73TC1
1405 Thuronyi, op.cit.(note10), p.180
1406 73TCat56(para.1)
1407 73TCat56(para.29)
1408 [1984]STC153at159
1409 73TCat69(para.48)
1410 73TCat69-70(para.48)

Lord Hoffmann emphasised that "Lord Brightman's formulation in the *Furniss* case is not a principle of construction [;] it is a statement of the consequences of giving a commercial construction to a fiscal concept."[1411] He also said,

> "Before one can apply Lord Brightman's words, it is first necessary to construe the statutory language and decide that it refers to a concept which Parliament intended to be given a commercial meaning capable of transcending the juristic individuality of its component parts. But there are many terms in tax legislation which cannot be construed in this way. They referred to purely legal concepts which have no broader commercial meaning. In such cases, the *Ramsay* principle can have no application. It is necessary to make this point because, in the first flush of victory after the *Ramsay* [and subsequent cases], there was a tendency on the part of the Inland Revenue to treat Lord Brightman's words as if they are a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."[1412]

Thuronyi notes that "it is clear from *Westmoreland*, as well as earlier cases,[1413] that the Law Lords will not use the *Ramsay* doctrine as a rubber stamp on any assessment by the revenue when there is a whiff of tax avoidance in the air."[1414] In *Barclays Mercantile Business Finance Ltd v Mawson*[1415], the House of Lords held that "it did not justify the assumption that an answer could be obtained by classifying all concepts a priori as either 'commercial' or 'legal' as that would be the very negation of purposive construction."[1416] Additionally, this case illustrated "the need for a close analysis of what, on a purposive construction, the statute actually required."[1417] As the Court held that:

> ".... the proposition that if a statute laid down requirements by reference to some commercial concept it would usually follow that elements inserted into a composite transaction without any commercial purpose could be

[1411] 73TCat70(para.49)
[1412] 73TCat70(para.49)
[1413] E.g., *Craven v. White*, [1989]AC398
[1414] Thuronyi, op.cit.(note10), p.183
[1415] [2005]STC1
[1416] [2005]STC1at3
[1417] [2005]1All ER at98

disregarded, whereas if the requirements of the statute were purely by reference to its legal nature then an act having that legal effect would suffice, whatever its commercial purpose might have been was not an unreasonable generalisation. Nevertheless that proposition did not provide a substitute for a close analysis of what a statute meant.[1418]

The Court also held that:

"The essence of the new approach to the construction of revenue statutes first applied in the *Ramsay* case was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. However, the proposition that, in the application of any taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded elided those two steps and therefore that proposition went too far."[1419]

Lord Hoffmann expresses the view in *British Tax Review* that "this case has killed off the *Ramsay* doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes, perhaps the interpretation of utterances of any kind."[1420] Similarly, "the courts should be trusted to give effect to the intention of Parliament as expressed by statute."[1421]

However, in *IRC v Scottish Provident Institution*[1422], the House of Lords still accepted the *Ramsay* principle. According to the Appellate Committee, "since the decision of this House in [*Ramsay*] it has been accepted that the language of a taxing statute will often have to be given a wide practical meaning of this sort which allows (and indeed requires) the court to have regard to the whole of a series of transactions which were intended to have a commercial unity."[1423] The Committee continued:

1418 [2005]STC1at2-3

1419 [2005]STC1at2

1420 Leonard Hoffmann, "Tax Avoidance", British Tax Review 2005, Number 2, (London: Sweet&Maxwell, 2005), 203.

1421 ibid.p.197

1422 [2005]STC15

1423 [2005]STC15at25

"… it would destroy the value of the *Ramsay* principle of construing provisions such as s 150A(1) of the 1994 Act as referring to the effect of composite transactions if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned."[1424]

This case illustrated that the *Ramsay* principle remains alive in terms of a principle of construction: the court should look at the context in which the scheme is devised as a whole.

A purposive interpretation helps the court to counteract tax-avoidance schemes. This brings about 'justice'/'fairness'/'equity' but devalues 'certainty'. Legal uncertainty stems from two causes, i.e.

(a) how the purpose of the enactment can be discovered to give meaning to the words in the relevant taxing provisions, and

(b) to what extent the courts will examine the purpose behind the taxpayer's transaction to ascertain the legal nature of the transaction for applying the relevant taxing provisions.

Orow supports uncertainty under (a) that "the search for legislative intention itself can produce uncertainty."[1425] According to Avery Jones, "[for] the question 'how do the courts know what the purpose is?'[;] [the] answer presumably is that they have regard both to principles expressed in the legislation and to external materials, such as parliamentary reports."[1426] One also notes that:

"A purposive construction is one that gives effect to the legislative purpose either by following the literal meaning of the enactment where that meaning is in accordance with the legislative purpose, or by applying a strained

[1424] [2005]STC15at26
[1425] Orow, op.cit.(note1389), p.412
[1426] Avery Jones, op.cit.(note1284), p.79

meaning where the literal meaning is not in accordance with the legislative purpose."[1427]

However, the courts cannot resort to the literal meaning of the enactment to seek the legislative purpose in all cases. This is because if an interpretation based on the literal meaning leads to injustice (because the taxpayer could avoid paying tax), the courts should strive to avoid adopting it. A purposive interpretation based on a strained meaning by having regard to external materials (such as parliamentary material) would be a better approach to seek the legislative purpose. This will reduce uncertainty under (a).

As regards (b), a judicial rule in *Ramsay* or the rule allowing the courts to devise the approach to determine the true legal effect of the transaction to which it is sought to attach a tax has been either extended or limited by subsequent cases. Such extension or limitation makes a judicial anti-avoidance rule uncertain. The TLRC supports the view that a judicial rule "offers no clear framework within which it shall operate or not."[1428]

To make this rule certain is not easy because it depends upon facts and transactions in each case and upon different judicial attitudes.[1429] The TLRC recommends that "the judges must develop a judicial anti-avoidance doctrine within the constraints imposed by their role as interpreters of the law rather than as lawmakers."[1430] This recommendation may reduce uncertainty from a judicial rule.

5.7 Improvements

5.7.1 Improvements in judicial interpretation in the UK[1431]

In the case of ambiguity, the UK courts use parliamentary material as an aid in interpreting ambiguous words. However, parliamentary material is insufficient to encourage legal certainty. A purposive interpretation may also bring about uncertainty.

[1427] Simon's Direct Tax Service:Binder2, op.cit.(note79), p.1315
[1428] TLRC, op.cit.(note7), p.xii
[1429] ibid.p.31
[1430] ibid.p.31
[1431] The improvement in judicial interpretation in the UK will be helpful to discuss that in Thailand thereafter.

As discussed in 3.2.2.2, the TLRC proposes that there should be explanatory memoranda to support primary tax legislation to assist understanding and interpretation. In terms of helping the courts, explanatory memoranda would help the courts (a) to resolve ambiguities in the legislation and (b) to apply a purposive interpretation.

As regards (a), explanatory memoranda would contain explanations of how each clause of the tax statute would operate, worked examples, answers to difficult points or any other relevant matter.[1432] The TLRC proposes that explanatory memoranda should have the same status as parliamentary material (Hansard) in the courts[1433]; and the courts should have to strike the balance between explanatory memoranda and Handsard.[1434] Nevertheless, the TLRC expects that the courts should no longer consult Handsard for interpreting tax legislation where explanatory memoranda are available.[1435]

As regards (b), a purposive interpretation requires "consideration of the legislative history of the enactment, including the pre-enacting, the enacting, and the post-enacting history."[1436] As explanatory memoranda would contain background material and explanations of the purpose of each clause of the tax statute, they would help the UK courts to identify Parliament's intention.[1437]

Thus, if the courts could consult explanatory memoranda in addition to parliamentary material to identify Parliament's intention, this would ensure legal certainty. However, the TLRC expresses the view that "in some cases statements of purpose may be a better way to identify Parliament's intention [than explanatory memoranda] since they have full legislative force."[1438]

1432 TLRC, op.cit.(note1128), p.viii
1433 TLRC, op.cit.(note1215), p.39
1434 TLRC, op.cit.(note1128), p.43
1435 ibid.p.43
1436 Simon's Direct Tax Service:Binder2, op.cit.(note79), pp.1308-1309
1437 TLRC, op.cit.(note1128), p.64
1438 TLRC, op.cit.(note1215), p.10

5.7.2 Improvements in judicial interpretation in Thailand

The Thai courts are not allowed to use parliamentary material as guidance to interpret ambiguous words. It would be further helpful to reinforce legal certainty if they could consult parliamentary material to interpret such words.

Additionally, the Thai government should adopt the TLRC's proposal of explanatory memoranda and statements of purpose for supporting new legislation. And the Thai courts should consult both explanatory memoranda and statements of purpose to help interpret the ambiguous words of the future tax legislation.

The Thai courts have not applied a purposive interpretation. The question arises whether they should adopt this approach. From my standpoint, where there are clear words in taxing Acts, they should be construed strictly to ensure legal certainty. The Thai courts should nevertheless adopt the purposive approach for two purposes, i.e.

(a) to interpret ambiguous words, and

(b) to counteract tax-avoidance schemes.

As regards (a), looking at the context and scheme of the relevant Act to identify Parliament's intention would help the courts to interpret ambiguous words. Consulting parliamentary material, explanatory memoranda and statements of purpose would be helpful to perform this task.

As regards (b), a purposive interpretation should be applied where:

(i) the taxpayer's transaction is abusive or relies upon artificiality; and

(ii) a strict interpretation (if applied) would not combat artificial/abusive tax-avoidance schemes, and a purposive interpretation could operate oppositely.

To reduce legal uncertainty, the Thai courts should consult parliamentary material, explanatory memoranda and statements of purpose (if any), and confine their role as interpreters of the law.

6. Statutory anti-avoidance rules

6.1 Objections to a judicial rule

As we saw, a judicial anti-avoidance rule results in legal uncertainty. Additionally, there are two objections to the rule:

(a) the role of the courts vis-à-vis the legislator, and

(b) retroactive effect.

As regards (a), there are arguments for and against the role of the courts in filling gaps and loopholes in the legislation to prevent tax avoidance. Brooks argues that "where there is a gap in the statute, ... there is really no option but for the courts to engage in the creative process of law making."[1439]

Whilst, Vanistendael argues that "most people however see a more limited role for the courts [;] [when] there is clearly no legal basis for taxation in the text of the law, there is no reason for the court to legislate judicially."[1440] This argument is based on the doctrine of the separation of powers which holds that "it is not for the judiciary to legislate."[1441] And it is the task of Parliament to enact anti-avoidance legislation.[1442]

Regarding (b), the TLRC says that the reason why a judicial rule is unsatisfactory is that it operates retrospectively.[1443] Meanwhile, Lymer *et al.* say that a statutory rule operates prospectively; therefore, the Revenue "can stop a scheme from being used again but legislation changes alone cannot be used to foil a scheme which has already been executed."[1444] Likewise, "to render loopholes ineffective, they must be closed with retroactive effect."[1445] However, the retroactive effect of a judicial rule may undermine legal certainty which demands that "an individual can arrange his affairs in the expectation that he will or will not have to pay tax."[1446]

Despite objections, the judges should not be denied absolutely from participation in developing the anti-avoidance approach. This is because a judicial

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[1439] Brooks, op.cit.(note1329), p.101
[1440] Vanistendael, op.cit.(note1381), p.153
[1441] ibid.p.133
[1442] Thuronyi, op.cit.(note10), p.138
[1443] TLRC, op.cit.(note7), p.xii
[1444] Lymer, et al., op.cit.(note120), p.1/20
[1445] Thuronyi, op.cit.(note10), p.152
[1446] Tiely, op.cit.(note6), p.102

rule brings about fairness, protects public revenues, prevents an adverse effect on redistribution, and has a retroactive effect on the closure of tax-avoidance loopholes. Furthermore, "[a judicial rule] can develop gradually and cannot be undermined by microscopic examination in the search for loopholes."[1447] Moreover, "the more modern notion is that legislative power *generally* is founded on the generalised consent of the citizen given in Parliament, but that has not been taken to prevent the development of the common law as a whole."[1448]

Therefore, if we want to rely solely upon statutory anti-avoidance rules (specific and general provisions), such rules should:

(i) protect tax revenues;
(ii) generate justice/fairness/equity;
(iii) create legal simplicity;
(iv) bring about legal certainty;
(v) not impede ordinary commercial dealings; and
(vi) not give excessively discretionary powers to the tax gatherer.

6.2 Specific anti-avoidance rules (SAARs)

The UK has adopted SAARs to deal with particular tax avoidance schemes/transactions.[1449] SAARs "identify with precision the type of transaction to be dealt with and prescribe with precision the tax consequences of such a transaction."[1450] Parliament can legislate SAARs promptly when unacceptable tax schemes are discovered.[1451] SAARs are therefore a better approach than a judicial rule to prevent loss of tax revenues through tax avoidance.

Tiley notes that "tax equity demands that artificial tax avoidance schemes should be of no effect." [1452] However, SAARs cannot absolutely satisfy this criterion. That is, although SAARs can prevent specific abuses, "they will never be

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1447 Brian J. Arnold, "Chapter 7: The Canadian General Anti-Avoidance Rule", Tax Avoidance and The Rule of Law, Graeme S. Cooper, ed., (Amsterdam: IBFD Publications BV, 1997), 226.
1448 Edwin Simpson, "The *Ramsay* Principle: A Curious Incident of Judicial Reticence?", British Tax Review 2004 (London: Sweet&Maxwell, 2004), 365.
1449 Cooper, op.cit.(note1377), p.40
1450 Collision and Tiley, op.cit.(note1111), p.180
1451 TLRC, op.cit.(note7), p.8
1452 Tiley, op.cit.(note6), p.100

completely effective in stopping abuse."[1453] This is because the taxpayer may find transactions that SAARs do not cover.[1454]

Likewise, the introduction of SAARs creates new avoidance opportunities because SAARs act "as a 'road map' for tax planners."[1455] Consequently, "a spiral develops in which the blocking of one loophole is followed by the identification of another, and so on."[1456] This contributes to legal complexity, increasing administrative and compliance costs. Thus, SAARs dissatisfy the criterion of simplicity, and prevent efficiency of taxation. The UK has a number of SAARs.[1457] Most of them can be found in TA1988, Part XVII.[1458] Additionally, Finance Acts contain a long list of SAARs.[1459]

SAARs under the UK law are detailed provisions.[1460] As noted earlier, detailed provisions are needed for legal certainty. Additionally, "a targeted approach is consistent with the traditional UK legal view that legislation should state clearly the circumstances in which a liability to tax arises."[1461] Moreover, SAARs can run from a certain date.[1462] This seems that SAARs satisfy the criterion of certainty.

However, detailed SAARs also mean extensive and complex provisions. As a result, "taxpayers and their advisers routinely urge governments to use narrowly and precisely drafted, targeted provisions to give them the certainty they require."[1463] The TLRC notes that "the clearer the boundaries drawn by the legislation, the easier it may be for taxpayers to arrange their affairs to fall on one side of the boundary or another."[1464] Consequently, "there are incentives to draft anti-avoidance measures ever more widely, even at the risk of catching innocent transactions."[1465] One has

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1453 Thuronyi, op.cit.(note10), p.152
1454 ibid.p.197
1455 TLRC, op.cit.(note7), p.4
1456 ibid.pp.4-5
1457 Thuronyi, op.cit.(note10), p.198
1458 Tookey, op.cit.(note1), p.364
1459 TLRC, op.cit.(note7), p.6
1460 Thuronyi, op.cit.(note10), p.152
1461 TLRC, op.cit.(note7), p.8
1462 Tiley, op.cit.(note6), p.100
1463 TLRC, op.cit.(note7), p.5
1464 ibid.p.5
1465 ibid.p.5

found that SAARs in TA 1988, Part XVII (ss 703-787) "impose heavy liabilities in respect of many kinds of ordinary and innocent transactions."[1466]

Thus, SAARs unduly affect ordinary commercial dealings. Troup's recommendations below are likely to solve this problem.

> "Where a loophole is discovered, the intention to legislate can be announced (provided that that intention is clearly stated) but there should then be adequate consultation and a real determination to target any provisions with certainty and with clarity."[1467]

Thuronyi notes, "common law countries … typically include [SAARs] that apply only where the tax administration can prove that the taxpayer acted with a tax avoidance purpose."[1468] This seems that SAARs do not give excessively discretionary powers to the tax gatherer. Nevertheless, many examples of discretionary powers exercisable by the Revenue are found in TA 1988, Part XVII (ss 703-787).[1469] Troup's recommendation below is likely to help protect innocent people from unacceptable discretion.

> "Where necessary, a discretion can be given to the Revenue as to the application of the provisions but the discretion must be properly hedged about with an adequate appeal procedure."[1470]

6.3 General anti-avoidance rules (GAARs)

GAARs have been adopted in many continental countries[1471] (e.g. France, Germany, the Netherlands, and Spain).[1472] Meanwhile, the UK tax system has no GAARs.[1473]

Legislators cannot anticipate all possible forms of tax avoidance schemes/transactions. Therefore, SAARs that deal with specified schemes/transactions will inevitably leave tax loopholes.[1474] GAARs aim to cover "a

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1466 Simon's Direct Tax Service:Binder 2, op.cit.(note 79), pp.1336-1337
1467 Edward Troup, "Unacceptable Discretion: Countering Tax Avoidance and Preserving the Rights of the Individual", Fiscal Studies (1992) Vol. 13, No. 4, p.138
1468 Thuronyi, op.cit.(note10), p.201
1469 Simon's Direct Tax Service:Binder 2, op.cit.(note79), p.1337
1470 Troup, op.cit.(note1467), p.138
1471 Tiley, op.cit.(note6), p.101
1472 Vanistendael, op.cit.(note1381), p.144
1473 ibid.p.144
1474 TLRC, op.cit.(note7), p.6

range of unspecified schemes where the dominant purpose is to avoid tax."[1475] Therefore, GAARs bring about equity because they make unspecified schemes no effect. Likewise, GAARs prevent people from avoiding tax under unspecified schemes which SAARs cannot deal with. And if people who cannot obtain a tax advantage from such schemes are the rich, this will promote income redistribution. GAARs also prevent loss of tax revenues via tax avoidance that SAARs cannot do.

Unlike SAARs, GAARs satisfy the criterion of simplicity and efficiency of taxation because they do not contribute to legal complexity on two grounds. First, GAARs do not require detailed provision. This is because GAARs set out broad criteria to be applied to any tax avoidance scheme/transaction "without being tied to specific cases."[1476] Secondly, GAARs possibly break "the development of the legislative spirals."[1477] As we saw, SAARs lead to the legislative spirals in which "the blocking of one possible loophole is followed by the identification of another, and so on."[1478]

GAARs operate prospectively; however, the broad scope and application of GAARs contribute to legal uncertainty. The broad scope and application of GAARs mean that provisions "do not say with precision in what circumstance tax will be imposed."[1479] Additionally, their broad scope and effectiveness "depend ultimately upon the interpretation of the provision by the courts."[1480]

To provide legal certainty, GAARs must distinguish between acceptable and unacceptable transactions. Arnold says, "this distinction is central to [GAARs]."[1481] Acceptable transactions to which GAARs will not apply include legitimate tax planning or mitigation.[1482] Meanwhile, unacceptable transactions to which GAARs will apply are those which have no legitimate business purpose and/or are primarily intended to avoid tax.[1483]

1475 Michael Brooks and John Head, "Chapter 2: Tax Avoidance: In Economics, Law and Public Choice", Tax Avoidance and The Rule of Law, Graeme S. Cooper, ed., (Amsterdam: IBFD Publications BV, 1997), 72.
1476 TLRC, op.cit.(note7), p.33
1477 ibid.p.34
1478 ibid.p.34
1479 ibid.p.32
1480 ibid.p.33
1481 Arnold, op.cit.(note1447), p.228
1482 TLRC, op.cit.(note7), p.xv
1483 Brooks and Head, op.cit.(note1475), p.72

Salter notes that "tax avoidance and tax evasion are quite distinct."[1484] On this basis, "evasion of tax by presenting false records, willful non-disclosure and so on, is also not within the purview of a GAAR."[1485] The following definitions of the terms 'tax minimization', 'tax avoidance', and 'tax evasion' are likely to make the distinction among these terms not become blurred.

Thuronyi notes that "tax minimization (tax mitigation, tax planning) is behavior that is legally effective in reducing tax liability."[1486] Tiley notes that "tax planning is what all sensible people do in order to reduce their tax liabilities."[1487] He also notes that "tax mitigation arises where the taxpayer takes advantage of a fiscally attractive option afforded by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option."[1488]

The TLRC has regarded tax avoidance as "action taken to reduce or defer tax liabilities in ways that Parliament plainly did not intend or could not possibly have intended had the matter been put to it."[1489] This is similar to the formulation by Lord Nolan in *IRC v Willoughby.*[1490] He said that tax avoidance is "a course of action designed to conflict with or defeat the evident intention of Parliament."[1491]

Kessler notes that tax evasion is "conduct which constitutes a criminal offence (fraud on the Revenue or similar offences) [;] this normally involves dishonest submission of an incorrect tax return."[1492] However, Freedman notes that "not all evasion is criminal."[1493] It is found that "dishonesty is essential to the offence."[1494] This necessity can be found in section 144 of the Finance Act 2000 which introduced the offence of fraudulent evasion of income tax. It is provided,

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1484 David Salter, "Some Thoughts on Fraudulent Evasion of Income Tax", British Tax Review 2002 (London: Sweet&Maxwell, 2002), 501.
1485 Cooper, op.cit.(note1377), p.27
1486 Thuronyi, op.cit.(note10), p.156
1487 Tiley, op.cit.(note6), p.94
1488 ibid.p.94
1489 TLRC, op.cit.(note7), p.3
1490 70TC57at116
1491 TLRC, op.cit.(note7), p.3
1492 James Kessler, "Tax Avoidance Purpose and Section 741 of the Taxes Act 1988", British Tax Review 2004 (London: Sweet&Maxwell, 2004), 376.
1493 Judith Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle", British Tax Review 2004 (London: Sweet&Maxwell, 2004), 347.
1494 Kessler, op.cit.(note1492), p.376

inter alia, that: "A person commits an offence if he is knowingly concerned in the fraudulent evasion of income tax by him or any other person."

Salter notes that "the phrase 'knowingly concerned' requires knowledge of (rather than mere suspicion) and involvement in the evasion of income tax."[1495] He further elaborates that "in relation to section 144, it can be argued that it should be sufficient that the defendant was aware that an evasion of income tax occurred and that he knowingly participated in it, and thus a charge may be framed accordingly." [1496]

Regarding 'fraudulent evasion', Salter notes that "[it] necessitates the proof of a dishonest intent."[1497] He further notes that "...no action would be taken in such cases under section 144 unless there was dishonesty."[1498] He also opines that "the probable attribution of dishonesty to the word 'fraudulent' will mean that proof of an integral part of the new offence will be dependant in each case upon what stance a jury or magistrates take(s) to the question of whether or not dishonesty is present, which may be difficult to predict."[1499] Freedman notes that "whether innocent or dishonest, evasion will lead to re-assessment for tax purposes but only dishonesty should result in criminal prosecution."[1500]

Vanistendael notes that tax avoidance is an action that does not constitute a criminal offense.[1501] A question arises whether a taxpayer and his tax advisers commit an offense under section 144 if an avoidance scheme is not successful. Salter refers to a particular view of some members of the House of Commons Standing Committee H that "those involved in fiscally ineffective tax avoidance schemes should not be regarded as being within the ambit of section 144."[1502] He supports this view on two grounds (a) "tax avoidance and tax evasion are quite distinct", and (b) "the often highly artificial and complex nature of such avoidance schemes should not necessarily be perceived as evidence of dishonesty on the part of those who devised

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[1495] Salter, op.cit.(note1484), p.492
[1496] ibid.pp.497-498
[1497] ibid.p.492
[1498] ibid.pp.501-502
[1499] ibid.p.505
[1500] Freedman, op.cit.(note1493), p.348
[1501] Vanistendael, op.cit.(note1381), p.132
[1502] Salter, op.cit.(note1484), p.501

and implemented them."[1503] Tiley also supports the view that "at present, tax avoidance is lawful whether or not it is successful, [which] means that if an avoidance scheme is attempted, but fails, the taxpayer must simply pay the tax with any interest or surcharges."[1504]

It is clear from the above that 'tax minimization' ('tax mitigation', 'tax planning'), 'tax avoidance', and 'tax evasion' are distinct. If GAARs could draw a distinction among these terms and specify that only a scheme/transaction which has 'tax avoidance' as a primary purpose was within its scope, this would help provide legal certainty. The TLRC supports the view that "[GAARs] can describe the nature of the arrangements that fall within its scope of operation and – equally important – it can explicitly specify the arrangements that remain outside its scope."[1505] This is the advantage of the GAAR over a judicial rule.[1506]

In 1997, the TLRC proposed the adoption of GAARs in the UK. In October 1998, the Inland Revenue published its Consultative Document dealing with GAARs for direct taxes. The TLRC Report and the Consultative Document both envisage that "the trigger for the GAAR would be a transaction that has as its sole or main purpose the avoidance of tax."[1507] Similarly, the GAAR would apply to the transaction that is designed to avoid tax in a way contrary to Parliament's intention.[1508]

However, "it is not always easy to discern Parliament's taxing intentions, especially in the case of novel and complex transaction."[1509] The TLRC Report and the Consultative Document both envisage that "a list of factors would be used to determine the [tax avoidance] purpose"[1510], which includes a tax benefit in mind[1511] and the obtaining by a taxpayer of a tax benefit.[1512] This would help provide legal certainty.

[1503] ibid.p.501
[1504] Tiley, op.cit.(note6), p.97
[1505] TLRC, op.cit.(note7), p.xiv
[1506] ibid.p.xiv
[1507] TLRC, A General Anti-Avoidance Rule For Direct Taxes: A Response to the Inland Revenue's Consultative Document (London: IFS, 1999), 11.
[1508] In the case of a composite transaction, the GAAR "would apply [where that transaction (taken as a whole)] had tax avoidance as a main purpose, without the need to consider its individual steps." (ibid.p.13)
[1509] ibid.p.5
[1510] ibid.p.11
[1511] ibid.p.14
[1512] Cooper, op.cit.(note1377), p.33

Based on the distinction between acceptable and unacceptable transactions, GAARs would not apply to 'a protected transaction' or 'acceptable tax planning.' This would also be helpful in providing legal certainty. According to the TLRC Report, a transaction would be a protected transaction if it:

(a) "can reasonably be regarded as encouraged by legislation"[1513],

(b) "falls within an exception to, or an exclusion from, other anti-avoidance provisions"[1514], or

(c) "otherwise does not conflict with or defeat the purpose of the legislation."[1515]

In the case of a multiple step transaction, GAARs would not apply "where that transaction (taken as a whole) is entirely or mainly a protected transaction."[1516]

According to the Consultative Document, the following fact would indicate acceptable tax planning:

(a) that "the purpose of a transaction is to take advantage of a relief or allowance provided by the tax legislation"[1517], or

(b) that "a transaction is specifically excepted from an anti-avoidance provision."[1518]

It is argued that "if the scope of [GAARs] is too widely drawn, this would create a serious impediment to commercial and personal transactions."[1519] Similarly, GAARs "has created a significant scope for uncertainty in commercial dealings."[1520] In addition to providing legal certainty, the Rule that provides exceptions for certain transactions (e.g. a protected transaction or acceptable tax planning) is a safeguard for ordinary commercial dealings. Furthermore, GAARs that incorporate a clearance procedure will provide greater certainty and protect the interests of taxpayers. This is another advantage of GAARs over a judicial rule.

The TLRC expresses the view that "the more broadly [the GAAR] is cast, the greater is the need for taxpayers and their advisers to seek advance clearances [from

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[1513] TLRC, op.cit.(note1507), p.13
[1514] ibid.p.13
[1515] ibid.p.13
[1516] TLRC, op.cit.(note7), p.38
[1517] TLRC, op.cit.(note1507), p.14
[1518] ibid.p.14
[1519] TLRC, op.cit.(note7), p.xvi
[1520] Orow, op.cit.(note1389), p.410

the Revenue] to secure the certainty that they require [or to ascertain whether proposed transactions would be regarded by the Inland Revenue as falling within the scope of the GAAR]."[1521] The clearance procedure could be implemented if the Revenue had sufficient resources and experienced and trained officials to deal with clearance applications within a short time to avoid inhibiting ordinary commercial dealings.[1522] Additionally, if the clearance application is refused, the taxpayer should be able to appeal to an independent tribunal.[1523]

The Consultative Document agrees that GAARs must incorporate a clearance procedure[1524], and proposed that a clearance application should include a technical analysis (for the Revenue to fully understand the facts)[1525] and be published (in anonymised form).[1526] It also proposes that some charge will be made for clearance applications.[1527] However, the TLRC criticizes that "a taxpayer should not have to pay to confirm that his transaction is entirely acceptable for tax purposes."[1528] For charging and administrative cost reasons, the UK Government rejected the Revenue's proposal for the introduction of GAARs in March 1999.[1529]

The final point to discuss is whether GAARs would give excessively discretionary powers to the Revenue if they were adopted. GAARs inevitably require the Revenue to opine at the outset whether the taxpayer's transactions fall within the Parliamentary intent.[1530] This probably extends the scope of the Revenue's power, which may interfere ordinary commercial dealings. There should therefore be a limitation on the scope of the Revenue's power in applying GAARs. The TLRC proposes that only the Head Office of the Revenue concerned should invoke the Rule.[1531] When invoking the Rule, the Revenue must show "why transaction is of a

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1521 TLRC, op.cit.(note1507), p.8
1522 ibid.p.8
1523 TLRC, op.cit.(note7), p.xvi
1524 TLRC, op.cit.(note1507), p.18
1525 ibid.p.20
1526 ibid.pp.21-22
1527 ibid.p.21
1528 ibid.p.21
1529 Tiley notes that "the government was not willing to pay the financial costs of [a pre-clearance or rulings system], nor was it willing to pay the political cost of trying to force such a system onto taxpayers." (Tiley, op.cit.(note6) p.102)
1530 TLRC, op.cit.(note7), p.35
1531 ibid.pp.xv-xvi

nature that [GAARs] ought to apply."[1532] It must also state "the alternative transaction that it considers should be substituted for the actual transaction as the basis for assessing tax."[1533]

6.4 Disclosure rules

In addition to SAARs, the disclosure rules have been introduced to counter tax avoidance in the UK, as from 1 August 2004.[1534] Part 7 of the Finance Act 2004 (FA2004) provides the framework for the rules[1535], which have been elaborated by regulations.[1536]

The rules require promoters and, in some cases, users of tax avoidance schemes to notify the Revenue of such schemes as summarized below.

(a) A promoter[1537] must, within 5 days[1538], notify the Revenue of:

(1) information on any notifiable proposal[1539] after he makes the proposal available for implementation by any person, or if earlier, after he first becomes aware of any transaction forming part of notifiable arrangements implementing the proposal, and

(2) information on notifiable arrangements[1540] after he first becomes aware of any transaction forming part of those arrangements (unless

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[1532] ibid.p.xiv

[1533] ibid.p.xvi

[1534] Section319, FA2004

[1535] The Act applies to all the direct taxes, but regulations restricted disclosure in the initial phase to remuneration schemes and financial products. Stamp duty land tax schemes were added in 2005. As from 1 July 2006, the rules are extended to include the whole of income tax, corporation tax and capital gains tax. (HMRC, BN 63 - Modification and extension of the disclosure regime, http://www.hmrc.gov.uk/budget2006/bn63.htm as of 28/07/2006, 1.)

[1536] Revenue Press Release 22 June 2004

[1537] A person is a promoter if, in the course of providing tax services, he makes available for implementation or design proposals and arrangements prescribed by *regulations.* (Section 307, FA 2004) More details of definition and duty of promoter can be found in **Appendix X to Chapter Five**.

[1538] Reg 4, SI 2004/1864

[1539] It is a proposal for arrangement which, if entered into, would be notifiable arrangements. (Section 306, FA 2004)

[1540] They are any arrangements of a description prescribed by *regulations* which enable or expect to enable any person to obtain a tax advantage, and that tax advantage is the main benefit, or one of the main benefits of the arrangements. (Section 306, FA 2004)

SI 2004/1863 described the proposals and arrangements which a promoter must notify to the Revenue. As from 1 July 2006, SI 2004/1863 are revoked and new regulations contain hallmarks (descriptions of arrangements in line with the system used for VAT). If a tax scheme falls within any one hallmark then it will be notifiable. (HMRC, op.cit.(note1535) ,p.2)

SI 2004/1864 prescribe the information that need to be notified, including a summary of the tax scheme and the statutory provisions relied upon.

the arrangements implement a proposal in respect of which has been notified under (1)).[1541]

(b) Where there is a non-UK resident promoter (and no UK resident promoter), persons entering into notifiable arrangements must notify the Revenue of information on those arrangements within 5 days after doing so.[1542]

(c) Where there is no promoter, persons entering into notifiable arrangements must notify the Revenue of information on those arrangements by the date they would normally have had to notify the Revenue of the scheme reference number (had one been allocated).[1543]

The Revenue may, within 30 days of being notified, allocate a reference number to the notifiable arrangements or proposals, and inform the number to the person who notify information.[1544] The promoter must pass on to the client the reference number within 30 days after he first becomes aware of any transaction forming part of the arrangements or, if later, after the reference number is informed to him.[1545]

A party to any notifiable arrangements must notify the Revenue of the reference number informed to him by the Revenue or by the promoter, and the time when the tax advantage is expected to arise. (This information must be included when filing the relevant tax return).[1546]

A person failing to comply with any of the disclosure obligations above shall be liable to Penalty of up to 5,000 pounds.[1547]

The rules do not require the disclosure of information subject to legal professional privilege (LPP).[1548] The client must notify the Revenue of information,

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[1541] Section 308, FA 2004
[1542] Section 309, FA 2004; Reg 4, SI 2004/1864
[1543] Section 310, FA 2004; Reg 4, SI 2004/1864
Businesses may have their own in-house tax departments which may devise tax avoidance schemes. In this case, the business itself must notify the arrangement. (Simon's Direct Tax Service Finance Act Handbook, The Finance Act 2004, (London: LexisNexisUK, 2004), 288.) As from 1 July 2006, the time limit for notification of in-house schemes is reduced to 30 days from the date that scheme is implemented; and neither individuals nor businesses that are SMEs will have to notify in-house schemes. (HMRC, op.cit.(note1535), pp.1-2)
[1544] Section 311, FA 2004
[1545] Section 312, FA 2004
[1546] Section 313, FA 2004; Reg 8, SI 2004/1864
[1547] Also, there are other penalties provided by section 315, FA 2004.

within 5 days of entering into the first transaction forming part of the arrangements, in place of a promoter where the promoter believes the relevant information is covered by LPP.[1549] However, the client may waive privilege, thereby allowing the promoter to notify the relevant information on his behalf.[1550]

The rules give extra powers to the Revenue, namely they enable the Revenue:

(a) "to see which returns under a self-assessment should be examined more closely"[1551], which will enable the Revenue "to check whether the right amount of tax, including any payments on account, have been paid"[1552]; and

(b) "to obtain much earlier notice of new arrangements so that, where appropriate, schemes can be blocked by targeted anti-avoidance provisions."[1553]

As regards (b), this may however lead to discretionary powers because the Revenue can "give quite some thought to the question whether the arrangements succeed or not."[1554] Discretionary powers may unduly affect legitimate/acceptable tax planning. Therefore, in construing and applying both disclosure rules and SAARs to information/arrangements disclosed, the Revenue should not go beyond the strict letter of the law. This will:

(i) protect legitimate/acceptable tax planning[1555],

(ii) provide legal certainty, and

(iii) strike down unacceptable tax schemes/arrangements which come within SAARs.

As regards (iii), artificial/abusive tax avoidance schemes will therefore be of no effect. (The rules aim to deter "the use of tax schemes that are abusive or rely

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1548 Section 314, FA 2004

1549 Reg 3, SI 2004/2613

1550 Revenue Press Release 6 October 2004

1551 Tiley, op.cit.(note6), p.99

1552 ibid.p.99

1553 Simon's Direct Tax Service, op.cit.(note1543), p.284

1554 Tiley, op.cit.(note6), p.99

1555 The Rt. Hon Dawn Primarolo says, ".... it is not the intention of the disclosure rules to stop accountants advising their clients on the tax breaks and the concessions that Parliament has introduced. That is entirely acceptable tax planning." (HMRC, Disclosure of Direct (IT,CGT, and CT) Tax Avoidance Schemes (The Main Guidance), July 2005, p.4 , available from HMRC's website at www.hmrc.gov.uk/aiu/index.htm.)

upon artificiality").[1556] This will bring about tax equity, promote income redistribution from the rich to the poor (if the rich cannot obtain a tax advantage or avoid paying tax from artificial/abusive tax avoidance schemes), and prevent loss of tax revenues. Hartnett, director general, HMRC says that the rules help HMRC "enormously to counter tax avoidance faster than [HMRC] would ever have done without this legislation."[1557] Meanwhile, most accounting firms "believed that the avoidance industry had been substantially disrupted."[1558]

Nevertheless, the rules undermine efficiency of taxation, which requires taxpayers to comply with tax law at low cost to themselves. The rules that provide the disclosure obligation impose costs on tax advisers, taxpayers and businesses - deadweight.[1559] For example, "most of the accounting firms had established a new centralised process for handling or co-ordinating [the disclosure rules]."[1560]

Furthermore, although regulations that have elaborated the rules in FA 2004 provide certainty for tax advisors, taxpayers and businesses[1561], the frequency of changes and the quantity of regulations probably contribute to complexity and increased compliance costs.[1562]

Finally, the rules may increase administrative costs because the implementation of the rules to achieve the above-mentioned aim requires disclosure departments (i.e. HMRC's Anti-Avoidance Group) staffed with "persons of sufficient technical calibre" to identify acceptable/unacceptable tax schemes/arrangements.[1563] And, if the rules are too widely drawn, it is less easy to identify the real abusive schemes.[1564]

1556 ibid.p.4

1557 David Earle, "Taken the money? Open the box!", Taxation, 6 October 2005, p.14

1558 ibid.p.18

1559 Tiley, op.cit.(note6), p.99

1560 Earle, op.cit.(note1557), p.15

1561 It is however noted that "both the primary legislation and the regulations leave much room for doubt about certain definitions." (Chamberlain, et al., op.cit.(note78), p.1004) In my view, to ensure certainty, regulations must not be too widely drawn because they are not subject to the same parliamentary scrutiny as Acts of Parliament.

1562 There are regulations including SI 2004/1863 (which are revoked and replaced), SI 2004/1864, SI 2004/1865, SI 2004/2429, SI 2004/2613, and SI 2005/1869. One notes that "the disclosure regime has been extended several times." (Author not identified, Accountancy, January 2006, Vol.137, p.102)

1563 Simon's Direct Tax Service:Binder2, op.cit.(note79), p.4904

6.5 Proposal for adoption of GAARs and disclosure rules in Thailand

Thailand has no GAARs. When tax loopholes are discovered, specific anti-avoidance provisions will be enacted to fill such loopholes.[1565] However, specific provisions create legal complexity (which deters efficiency of taxation), whereas GAARs operate oppositely.

Nevertheless, open-ended GAARs produce uncertainty, impede ordinary commercial transactions, and give the tax authorities' discretionary powers. Therefore, if GAARs were adopted in Thailand to support specific provisions to solve deficiencies that such provisions make, GAARs would have to:

(a) draw a distinction between acceptable and unacceptable transactions;

(b) apply to schemes/transactions which are designed to avoid tax in a manner contrary to legislative intention;

(c) allow an exception for legitimate/acceptable tax planning;

(d) incorporate a quick clearance procedure/a short-time pre-transaction rulings system under which there is no charge for applications[1566], and the taxpayer has the right to appeal against a refusal for his/her application;

(e) specify that only the Head Office of the Revenue Department (the RD) can invoke the Rule.

Additionally, the Thai government should have adequate resources and well-trained officials to deal with clearance applications.

Finally, as we saw, the disclosure rules probably counteract abusive tax schemes, but offer discretionary powers, increase administrative and compliance costs, and impose penalties for non-compliance. Therefore, if such rules were adopted in Thailand, the rules would not:

(a) be too widely drawn (to avoid much room for uncertainty about certain definitions, e.g. who must notify the relevant information, and whether a scheme is notifiable);

(b) be frequently amended (to avoid legal complexity and confusion); and

(c) give a too little period for preparation and notification of the information.

[1564] Chamberlain, et al., op.cit.(note78), p.1004

[1565] For example, Section 40 (4), RCT

Additionally, the RD must have experienced and well-trained officials who can identify the real abusive schemes and strictly apply the proposed disclosure rules and specific anti-avoidance provisions to the information disclosed.

7. Administrative practice

7.1 Features, advantages and disadvantages

Thai and UK tax authorities may make statements to help administer tax legislation. Such statements help reduce confusion and difficulty in applying the law, which support legal certainty and simplicity.

In Thailand, the RD has made statements including departmental notifications, departmental clarifications, and departmental instructions.

Departmental notifications explain or enlarge on the meaning of certain provisions of the RCT and delegated legislation[1567], which help taxpayers to understand and to comply with such provisions.

Departmental clarifications clarify certain provisions of the RCT and delegated legislation, which reduce confusion and difficulty for taxpayers in applying the law.

Departmental instructions provide the officers of the RD with guidelines on tax administration and collection.[1568] Departmental instructions result from there being insufficient details in certain provisions of the RCT and delegated legislation, causing difficulties in administrative operation. Departmental instructions are therefore intended to enlarge on or add details to tax provisions, which enable tax-gatherers to carry out their duties.

Since the above statements have no legal force, the taxpayer who disagrees with and is adversely affected by them can argue against them in court.

Tax rulings are another statements issued by the RD to taxpayers who are uncertain about the tax treatment of particular transactions. A ruling is an official view only. The taxpayer who requests the ruling may or may not comply with it.

[1566] Efficiency of taxation requires low compliance costs.
[1567] Suthep Pongpitak, "Question-Answer", RD Tax Journal, Year 46, Issue 10, October, 1999, 77.
[1568] "---" Issue 11, November, 1999, 61.

In the UK, the Revenue (which is part of HM Revenue & Customs) has issued statements including extra-statutory concessions (ESCs), Statements of Practice (SPs), News Releases, Tax Bulletin, guidance manuals, guidance leaflets, indirect guidance, post-transaction rulings, statutory clearances, and statutory approvals.

ESCs are "relaxations that give a reduction in tax liability that [the taxpayers] would not be entitled to under the strict letter of the law."[1569] (There will be more discussion on ESCs below).

SPs are issued to "explain [the Revenue's] interpretation of legislation and the way [the Revenue] apply the law in practice."[1570] They "deal with doubtful points, and questions which the law does not answer."[1571] As a result, they "operate as a shield for the taxpayer rather than a sword for the Revenue."[1572] They have no legal force. The taxpayer who disagrees with them can argue for a different interpretation before the courts.[1573]

News Releases are issued "to announce a proposed change in the law, a change in [the Revenue's] practice or some other change or initiative of interest to the public."[1574] **Tax Bulletin** is published "to inform tax practitioners of matters of technical interest, including [the Revenue's] interpretation of aspects of tax law."[1575] **Guidance manuals** are "the internal guidance manuals [that the Revenue's staff] use[1576]; however, "certain passages are held back for operational reasons."[1577] Guidance manuals cover "the interpretation of tax law and the operation of the tax system."[1578] **Guidance leaflets** "have been published for many years, but they have gained considerably in appearance and readability since the Revenue started taking the Plain English Campaign seriously, and they now regularly win praise for

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1569 HMRC, COP10: IR Code of Practice 10, http://www.hmrc.gov.uk/pdfs/cop10htm as of 24/07/2006, 2.
1570 ibid.p.2
1571 David W. Williams, "Extra Statutory concessions", British Tax Review 1979 (London: Sweet& Maxwell, 1979), 143.
1572 A. Foreman, The Allied Dunbar: Tax Handbook 1998-99 (London: Allied Dunbar Assurance plc, 1998), 10.
1573 Chamberlain, et al., op.cit.(note78), p.11
1574 HMRC, op.cit.(note1569), p.2
1575 ibid.p.2
1576 ibid.p.2
1577 Tiley, op.cit.(note6), p.59
1578 HMRC, op.cit.(note1569), p.2

clarity."[1579] **Indirect guidance** is the Revenue's letter sent to taxpayer representatives and professional associations about the operation of the taxes in its charge.[1580]

The above statements keep taxpayers informed of the movement of tax laws and the tax authorities' interpretation and application of tax law in practice, which reduce confusion and difficulty in applying tax law. However, Revenue interpretations have no legal force, "cannot, in the Revenue's view, require appropriate action by the taxpayer"[1581], and "the Revenue will not necessarily regard itself as bound by them."[1582]

A post-transaction ruling is "a ruling by [the Revenue] on the application of tax law to a specific transaction after that transaction has taken place."[1583] Tax rulings are of importance for the self-assessment system since they can assist taxpayers to ascertain tax law and practice, particularly concerning the tax treatment of their transactions. The taxpayers can apply for a post-transaction ruling when the tax treatment of the particular transaction is in doubt.[1584] In receiving rulings, the taxpayers can see their tax obligations and complete their tax returns.[1585]

Post-transaction rulings are merely official views. The taxpayer who disagrees with a post-transaction ruling cannot appeal against it.[1586] However, he/she is entitled not to comply with such ruling in his/her return. If the difference of opinion between the taxpayer and the Revenue cannot be resolved (after the return being completed and sent to the Revenue), the taxpayer can "appeal against the Revenue's assessment or amendment of [his/her] Self Assessment in the usual way."[1587]

[1579] Morse and Williams, op.cit.(note15), p.40
[1580] ibid.p.41
[1581] Collision and Tiley, op.cit.(note1111), p.43
[1582] Tiley, op.cit.(note6),p.59
[1583] HMRC, op.cit.(note1569), p.3
[1584] ibid.p.3
[1585] ibid.p.3
[1586] ibid.p.4
[1587] ibid.p.4

The Revenue is bound by a post-transaction ruling. However, the Revenue would not be bound by a post-transaction ruling if the information that the taxpayer gave were incorrect and incomplete.[1588]

Apart from post-transaction rulings, the taxpayers can apply to the Revenue for advice on the application of the law to a specific proposed transaction.[1589] In addition, the taxpayers can understand their rights and obligations by applying to the Revenue for statutory clearances or approvals for certain transactions. **Statutory clearances** are "advance rulings about the tax effect of certain transactions."[1590] Meanwhile, **statutory approvals** are "statutory approval to contractual or other arrangements."[1591]

Tax statutes entitle taxpayers to apply for statutory clearances or approvals, and the Revenue is obliged to give them. For example, taxpayers can apply for statutory clearances in respect of transactions in securities under section 707 of TA1988[1592]; and taxpayers can apply for statutory approvals in respect of pensions under sections 590 and 591 of the TA1988.[1593] Statutory clearances or approvals have the advantage of "helping people to understand their rights and obligations so they can get their tax affairs right and pay tax on time."[1594]

Statutory clearances or approvals are legally binding on the Revenue.[1595] However, the clearance given by the inspector can be withdrawn by the Revenue. This is not unfair and will not amount to an abuse of power by the Revenue if the taxpayer has not fully disclosed relevant facts and materials to the inspector. This is confirmed in *Matrix-Securities Ltd* v. *IRC.*[1596] Per Lord Templeman, the Revenue was entitled to revoke the clearance given by the Inspector. In this case, the material disclosed by the taxpayer was inaccurate and misleading.

1588 ibid.p.3
1589 ibid.p.5
1590 ibid.p.6
1591 ibid.p.6
1592 ibid.p.10
1593 ibid.p.11
1594 Revenue Press Release 2 April 1998
1595 Shipwright and Keeling, op.cit.(note1075), p.27
1596 [1994]STC272

The advantages of statements made by Thai and UK tax authorities may be undermined by three disadvantages.

(1) Instability of interpretation

Interpretation of tax law by the tax authorities that is unstable may create confusion for both tax-gatherers and taxpayers in applying the law. For example, according to the RD's ruling no. 0802/7536, dated 14th May 1996, a deduction of actual expenses is allowed for prizes won in lucky drawings under section 8 bis of Royal Decree (N0.11) B.E. 2502, provided that the person having such income produces evidence proving actual expenses. If he/she fails to produce evidence required, a standard deduction of 75 percent will be allowed as expenses.

However, according to the RD's ruling no. 0811/13116, dated 8th September 1998, a standard deduction is not allowed as expenses on prizes won in lucky drawings under section 8 of Royal Decree (N0.11) B.E. 2502. Instead, actual expenses will be deducted from such income under Section 8 bis of Royal Decree (N0.11) B.E. 2502.

(2) Lack of legal authority to give formal pre- and post-transaction rulings

Neither Thai law nor UK law has any provision calling for formal pre- and post-transaction rulings. When there is no law to force the tax authorities to give such formal rulings, the tax authorities may not speed up the issue of rulings or may give rulings at its discretion or under strict conditions.

There is no specified period of time required for applying and giving rulings under the Thai rulings system, and the issue of the Thai rulings is at the discretion of the RD. By contrast, the Revenue will normally give a post-transaction ruling within 28 days of the date of receiving the taxpayer's request[1597], and the Revenue will give them in accordance with procedures as set out in the IR Code of Practice 10.

(3) Broad scope of explanation, interpretation and application of tax law by the tax authorities via various statements

This may increase taxpayers' obligations and greatly affect their rights beyond the stated intention of enactment. The taxpayer who disagrees with the tax authorities' broad explanation, interpretation and application can appeal against them to the court, and he/she will probably win the case because they are against not only the principle of certainty but also the law. The Thai Supreme Court's decision in *Callbacks (Thailand) v. the Revenue Department*[1598] supports this point.

In this case, the RD issued Departmental Instruction No.Paw.2/2526 giving guidelines on the method of computation of tax withholding. This method of computation is different from that legislated in section 50 (1) of the RCT. Furthermore, the withholding tax calculated under this Departmental Instruction is not the same as that calculated under Section 50 (1). The Supreme Court held that tax assessment using the method of computation under this Departmental Instruction by the assessment officer is not legally enforceable.

As quoted earlier, the Revenue makes ESCs to reduce tax liability that "[the taxpayer] would not be entitled to under the strict letter of the law."[1599] ESCs are not passed by Parliament but are issued by persons "who have no legal power to do it."[1600] ESCs are therefore not law, and "the courts cannot enforce them or interpret them because they have never been enacted."[1601] Given this, the issue of ESCs is the application of tax law by the UK tax authorities beyond the stated intention of enactment.[1602]

ESCs will be in the interests of some taxpayers, but do not bring about benefits and fairness for taxpayers and society in general. Furthermore, ESCs do not comply with the criterion of certainty that requires tax rules to be reliable and non-arbitrary. This is because ESCs are made in favour of some groups of people at the Revenue's discretion (based on a list of concessions)[1603], and will not be given where the Revenue considers that an attempt is made to use them for tax avoidance.[1604]

1597 HMRC, op.cit.(note1569), p.5
1598 The Supreme Court's decision No.4083/2532
1599 HMRC, op.cit.(note1569), p.2
1600 Morse and Williams, op.cit.(note15), p.37
1601 ibid.p.37
1602 In *Vestey v. IRC [No2]* [1979] 2All ER225 at 233, Walton J commented that the issue of ESCs should be a matter for Parliament, and not the Inland Revenue Commissioners. In *Preston* v. *IRC* [1985] STC282 at 293, Lord Templeman said, "....the commissioners themselves must bear in mind that their primary duty is to collect, not to forgive, taxes."
1603 List of the Revenue's concessions and full texts are printed in a booklet issued by the Revenue.
1604 This term is printed on the inside cover of a booklet issued by the Revenue.

7.2 Improvements in administrative practice in both countries

In my view, in explaining, interpreting and applying the law via various statements, the Thai and UK tax authorities should not go beyond the strict letter of the law. This kind of administrative practice will:

- reduce confusion arising from the instability of interpretation of tax law;
- not increase taxpayers' obligations, nor greatly affect their rights beyond the stated intention of enactment; and
- make tax law more certain.

In the case of ambiguity, the Thai and UK tax authorities should consult parliamentary materials and explanatory memoranda (if any) to help interpret ambiguous legislation in the same way as the courts, as discussed in 5.7 and 5.8.

Additionally, detailed legislation should be preferred to purposive legislation. This is because the former would help prevent the tax authorities from explaining, interpreting and applying the law beyond the strict letter of the law, whereas the latter would allow the tax authorities to explain, interpret and apply the law beyond the strict letter of the law.[1605] Collision and Tiley support the view that

> "The Revenue position often prefers a broad legislative rule which can then be interpreted 'liberally' or not. The disadvantages of this are that such a rule may be interpreted unevenly and there is the possibility, however unlikely, of abuse."[1606]

Chamberlain, *et al.,* note, "[SPs] should be treated with caution since they may not accurately state the law."[1607] This possibly results from the Revenue's liberal and uneven interpretation.

As discussed above, ESCs are made at the Revenue's discretion, dissatisfying the criterion of certainty. In my view, one way to make tax rules reliable and non-arbitrary is that the tax authorities have to perform their duties according to the strict letter of tax statutes. Thus, the Revenue should no longer issue ESCs, as explained more below.

[1605] Also, GAARs would probably allow the tax authorities to use discretionary powers or apply the law beyond the strict letter of the law. Therefore, to prevent this, GAARs (if adopted) should restrict such powers and bring about certainty by incorporating rules as proposed in 6.5.

[1606] Collision and Tiley, op.cit.(note1111), pp.41-42

[1607] Chamberlain, et al., op.cit.(note78), p.12

Each tax statute has its own particular purpose under the strict provisions; for example, one of the primary purposes of the income-tax statute is to raise revenue. Therefore, if the income-tax statute wanted to allow relaxation to some taxpayers, such relaxation would have to be enacted by Parliament as provisions of such statute with which the Revenue would have to comply.

The concessions would therefore have to be made under the income-tax statute by Parliament rather than by the Revenue. It seems also unreasonable to say that concessions are made by the Revenue to deal with anomalies under the legislation and to meet cases of hardship which are difficult to remedy by statute.[1608] This is because these ought to be a matter for Parliament to deal with as Parliament has directly derived the power to do so from the Bill of Rights.

It would be justifiable for the Revenue to receive legal power from an Act of Parliament to make ESCs. An enabling Act should also lay down the ambit of concessions to avoid arbitrary power and to comply with the principle of certainty.

As discussed above, the tax authorities may not speed up the issue of rulings or may give them at their discretion because there is no law to force either Thai or UK tax authorities to give them. Thus, there should be provisions in both the Thai and UK tax Acts to stipulate the conditions for applying and giving formal post-transaction and pre-transaction rulings. The following conditions should be the essence of such rulings.

First, the tax authorities should be obliged to give formal pre- and post-transaction rulings on all requests (save for the purpose of tax avoidance or evasion) within a specified period of time. The rulings should cover all existing enforceable taxes.

Secondly, taxpayers should apply for tax rulings when they find that there is an ambiguity in a particular legislative provision to be applied to proposed transactions.

Thirdly, the procedure for applying rulings should not be complex. This will save the taxpayer's resources when preparing the application for a ruling; and the tax will be paid on time if the taxpayer agrees with the ruling. An uncomplicated procedure will also save the government's resources.

Fourthly, the information to be supplied with the application for a ruling must not be too difficult for the taxpayer. However, such information should indicate uncertainty on how tax law applies to a particular transaction. The law should however give relaxation with regard to the taxpayer's opinion and provide reasons for the tax consequences of the transaction as well as technical analysis.

Under the IR Code of Practice 10, in applying for informal rulings, taxpayers must supply information that is sometimes difficult for those who have no profound knowledge of tax law. For example, according to Appendix 1 of the Code, the taxpayer must give "a technical analysis that is sufficiently detailed for [the Revenue] to fully understand the facts and problem that [the taxpayer] wishes [the Revenue] to consider."[1609]

Fifthly, the tax authorities should be bound by given rulings, provided that the information supplied by the taxpayer is correct and complete.

Sixthly, a ruling given by the tax authorities is an official view only. Taxpayers may or may not comply with tax rulings.

Seventhly, in giving tax rulings, the tax authorities should not go beyond the strict letter of the law. This will also make tax law more certain and reduce confusion.

Finally, given rulings should be published regularly in the RD's Journal and the Revenue's Tax Bulletin. Such publication will assist the persons concerned to see the guidelines on the tax authority's application of tax laws to the particular transactions, make tax law easier to use, and lead to more foreign investment.

8. Tax collection: an overview

Although both Thailand and the UK adopt methods of withholding at source and self-assessment, the revenue share from the UK income tax is higher than that from the Thai PIT. Furthermore, although the cost of Thai tax collection is proportionately lower than that of UK tax collection, the methods of tax collection in question do not work well in Thailand.

[1608] Revenue press release 17 May 1985

[1609] HMRC, op.cit.(note1569), p.6

Revenue collection

PIT revenue in Thailand since the fiscal year 2003[1610] has been shown in Table 5.1 below.

Table 5.1[1611]

Year	% of total government revenue
2003	10.7
2004	11.0
2005	10.5

PIT revenue was not the largest source of revenue for the Thai government during these periods. The three largest sources were excise taxes, VAT and corporate income tax.

Meanwhile, the UK income tax was the largest single source of revenue for the UK government during the periods of 2003/04-2005/06. Income tax revenue in the UK since the year 2003/04 has been shown in Table 5.2 below.

Table 5.2

Year	% of total government revenue
2003/04[1612]	28.5
2004/05[1613]	28.1
2005/06[1614]	28.1

Costs of tax collection

In 1998, 1999, 2000 and 2001, the RD collected taxes with costs of 0.61, 0.68, 0.76, and 0.74 Baht per 100 Baht collected.[1615] Meanwhile, the costs of collecting taxes by the Inland Revenue in 2001/02, 2002/03, 2003/04 and 2004/05 were 1.38, 1.41, 1.36, and 1.34 pence per £ collected.[1616]

[1610] Year ending September 30

[1611] **Source**: Fiscal Policy Office, Ministry of Finance, http://dw.mof.go.th/foc/gfs/database/C1_Budgetary.html,as of 27/07/2006, 1.

[1612] **Source**: Stuart Adam and Jonathan Shaw, A Survey of The UK Tax System (updated November 2003), http://www.ifs.org.uk/taxsystem/taxsurvey.pdf, 3.

[1613] **Source**: Adam, op.cit.(note215), p.4.

[1614] **Source**: Adam and Browne, op.cit.(note75), p.4

[1615] These latest data are provided by an officer of the RD.

[1616] HMRC, Annual Report 2004-05 (Norwich: TSO, 2005), 104.

The low costs of tax collection are partly due to the fact that the private sector acts as an unpaid tax collector for the public sector under the system of withholding at source. Additionally, taxpayers may incur costs under the self-assessment system.

Nevertheless, a low cost of tax collection is not the only factor indicating whether tax administration is efficient. We also need to look at whether the methods of tax collection entail voluntary tax compliance and cheap compliance costs as well as absence of abuse of power and bribery in determining administrative efficiency.

9. Withholding at source ('withholding')

9.1 Features, advantages and disadvantages

Under Thai law, the payer of income ('the payer') from certain types of income must withhold tax at each time of payment[1617], and remit the tax withheld to the government within a prescribed period.

Despite 'withholding', Thai law still requires all individuals and married couples whose assessable incomes exceed a specified amount to complete and file end-of-year tax returns. To calculate the total amount of assessable income of a taxpayer for completing an end-of-year tax return, the tax withheld and remitted will be deemed the assessable income of the taxpayer and offset/credited against the final tax liability of the taxpayer.[1618] The taxpayer whose tax withheld at source exceeds his/her final tax liability can claim a tax refund[1619]; whereas the taxpayer whose final tax liability exceeds the tax withheld has to pay the excess.

Presently, many types of income, which cover eight categories of assessable income under the RCT, are taxed through 'withholding' at various rates. In the case where the recipient of the income ('the recipient') is liable to the PIT, 'the payer' must withhold tax at source at a rate varying according to the type of income, e.g. 3% (for income from liberal professions), 5% (for income from prizes in contests), 10% (for dividend income), 15% (for income from royalties), or 0-37% (for income from employment).[1620]

[1617] Section 50, RCT
[1618] Section 60, RCT
[1619] Section 63, RCT
[1620] More details can be found in **Appendix XI to Chapter Five**.

In the UK, 'withholding' includes withholding from (a) certain interest payments, (b) employees' earnings, and (c) income other than (a) and (b).

As regards (a), the payer of interest income (e.g. banks and building societies) is required to withhold income tax at source from the following interest payments at the rate of 20%, and remit the tax withheld to the Revenue:

- bank deposit interest "unless a claim has been made by a non-taxpayer to receive the income gross"[1621],
- building society interest "unless a claim has been made by a non-taxpayer to receive the income gross"[1622],
- debenture interest[1623]and other loan interest paid by UK companies[1624], and
- interest on UK government securities[1625]; however, "as from 6 April 1998, anyone receiving such interest may choose whether to receive the interest gross or net."[1626]

Unlike interest payments, company dividend payments have not been subject to withholding since the tax year 1999/00.[1627] The recipients of UK dividends now receive a tax credit of one-ninth of the amount of dividend.[1628] Such tax credits are charged to tax and deducted from the taxpayer's income tax liability on dividends.[1629] The result is that "there is no outstanding income tax liability except for higher rate taxpayers."[1630]

As regards (b), 'withholding' from employees' earnings is known as the Pay-As-You-Earn system ('PAYE').[1631] Under 'PAYE', employers are required to withhold income tax and National Insurance contributions from employees' earnings

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[1621] Nightingale, op.cit.(note65), p.73
[1622] ibid.p.73
[1623] ibid.p.73
[1624] Melville, op.cit.(note541), p.21
[1625] Nightingale, op.cit.(note65), p.73
[1626] Melville, op.cit.(note541), p.21
[1627] Walter Sinclair, Tax Guide 2003-2004 (Hampshire: Palgrave Macmillan, 2003), 9.
[1628] ibid.p.9
[1629] Melville, op.cit.(note541), p.26
Melville also notes, "it is not possible to claim payment of any tax credits which exceed [the taxpayer's liability] [;] [nor] is it possible to deduct tax credits from the tax due on other forms of income."
[1630] James and Nobes, op.cit.(note5), p.157
[1631] Section 203, TA 1988

at the time of payment[1632], and remit the tax withheld to the Revenue.[1633] 'Withholding' from wages and salaries is done on a cumulative basis, which covers "starting, basic and higher rate income tax."[1634]

James and Nobes explain a cumulative basis as follows:

> "Cumulation simply means that a taxpayer's pay and allowances are accumulated throughout the tax year so that the amount withheld in any one period is dependent on the income received throughout the tax year up to and including the current period."[1635]

'PAYE' applies to all earnings from employment (e.g. wages, salaries, bonus, commission, fees, pension, pay during sickness or other absence from work, and holiday pay).[1636] 'PAYE' also applies to transactions as follows:

(i) trade debts,

(ii) some payments to sub-contractors in the construction industry,

(iii) payments to outworkers, and

(iv) payments in the form of 'readily convertible assets.'[1637]

As regards (c), 'the payer' is required to withhold tax at source from the following income at the basic rate of 22%, and remit the tax withheld to the Revenue:

- income received under a deed of covenant,
- patent royalties, and
- income portion of a purchased life annuity.[1638]

Advantages of 'withholding'

There are at least four advantages of 'withholding', namely (a) stability of tax revenue, (b) prevention of avoidance and evasion, (c) reduction in the abuse of power and bribery, (d) convenience and low costs for tax-gatherers and individual taxpayers

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1632 Melville, op.cit.(note541), p.104

1633 Sinclair notes,

> "[The] employer has to pay over to the Collector of Taxes the total PAYE income tax deductions (less refunds) and National Insurance contributions in respect of the previous month. The time limit is by the nineteenth day of the following month."

(Sinclair, op.cit.(note1627), p.125)

1634 ibid.p.125

1635 James and Nobes, op.cit.(note5), p.170

1636 Melville, op.cit.(note541), p.104

1637 More details can be found in **Appendix XII to Chapter Five**.

1638 Nightingale, op.cit.(note65), p.72

As regards (a), 'withholding' improves "the speed and reliability of the government's income tax revenue"[1639] because 'withholding' reduces loss of tax revenue due to tax evasion and brings money into the government's treasury regularly.

As regards (b), 'withholding' reduces the opportunity and incentive for tax evasion[1640] because 'the payer' is responsible for the tax due, not the taxpayer who is the recipient.[1641] 'Withholding' under current Thai and UK laws covers increasing types of income and payment, which makes it more difficult for individuals to evade paying tax, i.e. by failing to report or underreporting income from legal activities. For example, under Thai law, 'withholding' is extended to income from liberal professions.[1642] The extended scope of 'withholding' also helps prevent tax avoidance. For example, PAYE that extends to payments in the form of 'readily convertible assets' prevents employers from avoiding PAYE by paying employees in assets.[1643]Consequently, 'withholding' helps reduce administrative costs to prevent and detect tax avoidance and evasion.

As regards (c), 'withholding' reduces corruption because under this system, tax-gatherers are not directly responsible for tax collection.

As regards (d), according to Adam Smith, having a great number of tax-gatherers and frequent visits of tax-gatherers produces high administrative costs[1644], and "frequent visitations from tax-gatherers" also increase compliance costs.[1645] As we saw, under 'withholding', 'the payer' must remit the tax withheld to the government. 'Withholding', therefore, reduces the number of tax-gatherers, the number of tax-gatherers' visits to individual taxpayers to assess and collect tax, which reduces administrative and compliance costs.

Additionally, compliance costs are reduced because under 'withholding', "the tax payment coincides with the receipt of income."[1646] This convenience enables most taxpayers to avoid completing end-of-year tax returns (as described below).

1639 Black, op.cit.(note140), p.344
1640 Whitehouse and Vaines, op.cit.(note695), p.106
1641 Lymer, et al., op.cit.(note120), p.4/12
1642 More examples can be found in **Appendix XIII to Chapter Five.**
1643 "---"
1644 James and Nobes, op.cit.(note5), p.20
1645 ibid.p.21
1646 Trotman-Dickenson, op.cit.(note138), p.82

This convenience also prevents tax evasion, because if 'the payer' did not withhold tax from income weekly or monthly, taxpayers would pay a large amount of tax at the end of the tax year. This might create a disincentive to pay tax. Furthermore, this convenience prevents bad debts because taxpayers might not have enough money to pay tax at the end of the tax year due to overspending during the year.

In the UK, most people whose income tax is withheld by 'PAYE' do not have to complete end-of-year tax returns.[1647] Given this, "the UK PAYE system takes the process of assessment and collection largely out of the hands of most taxpayers"[1648], reducing the compliance costs of those who have no burden of completing and filing end-of-year tax returns.

The reason why most UK wage and salary earners do not have to complete end-of-year tax returns is that the tax withheld equals final tax liability. This results from a cumulative PAYE system.[1649] Under the cumulative system, income tax on the earnings of those with simple affairs (e.g. starting-rate and basic-rate taxpayers) is withheld accurately at source throughout the tax year.

However, for those with high income and complex financial affairs (e.g. the self-employed, people with multiple sources of income, and company directors), there are difficulties in withholding tax accurately throughout the tax year, thereby requiring adjustment to the amount of tax already withheld at the end of the tax year on completion of tax returns.

As noted above, Thai law still requires individuals whose assessable incomes exceed a specified amount to complete and file end-of-year tax returns despite 'withholding'. For those whose tax withheld equals final tax liability (i.e. low- and middle-income wage and salary earners whose income taxes are withheld at source on a cumulative basis), the requirement for filing and completing end-of-year tax returns costs them time (and sometimes money). Dealing with tax returns of low-rate taxpayers by tax-gatherers also increases administrative costs disproportionately to the tax revenue received from them.

[1647] HMRC, Income Tax Statistics and Distributions, http://www.hmrc.gov.uk/stats/income_tax/income_tax_intro.pdf, as of 27/07/06, 2.

[1648] James and Nobes, op.cit.(note5), p.156

[1649] ibid.p.173

Disadvantages of 'withholding'

The advantages of 'withholding' may be undermined by five disadvantages.

(1) Many rules

Presently, in Thailand there are at least 11 pieces of legislation dealing with 'withholding': the RCT, two Royal Decrees, four Ministerial Regulations, and four Departmental Regulations. There are more than 50 main rules (and many sub-clauses) on 'withholding' in these laws. Rules on UK 'withholding' are found in the TA 1988, the ITEPA 2003, Finance Acts and PAYE Regulations 2003.[1650].

Numerous rules create complexity, confusion, difficulty, and high costs in making 'withholding' as well as in checking the correct amount of tax withheld.

(2) Many rates

There are more withholding tax rates under Thai law than under UK law. Many tax rates make the withholding system complex. Consequently, the system is difficult and confusing to comply with, imposing considerable costs on 'the payers'. Additionally, the complexity increases the costs of tax-gatherers in checking the correct amount of tax withheld.

(3) Inequity of taxation

'Withholding' can cause tax inequity. First, some incomes are taxed at source, whereas others are not. Secondly, there are differences between withholding tax rates.

Despite the extension of scope of 'withholding' in both Thailand and the UK, current 'withholding' in both countries cannot cover all types of payment. For example, under Thai law, 'withholding' does not cover all payments for sale of goods, whereas certain payments for sale of goods (e.g. payment for sale of goods made by government agency) are subject to 'withholding'.

Withholding tax rates under Thai law differ according to the type of income, 'the recipient' (Thai or non-Thai resident), and 'the payer' (a person, a juristic person, a non-juristic body of persons, or governmental agencies). Comparing two persons with equal income, a salary earner whose income is taxed at source at rates of 0-37% has disposable income during the tax year less than a contractor whose

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[1650] There will be Bill 4 to complete the Rewrite Project' work on income tax. The Draft Bill also include rewritten legislation for withholding at source. (HMRC, op.cit.(note1301), p.2) income is subject to a 3% withholding tax. Therefore, horizontal inequity emerges since individuals with equal income are taxed at source at different tax rates.[1651] Additionally, difference in withholding tax rates may encourage individuals to re-arrange their financial affairs to benefit from lower withholding tax rates.

(4) Tax loopholes and revenue loss

Thai law still requires all individuals to complete and file an end-of-year tax return despite 'withholding'. Additionally, an individual may elect to pay tax on certain types of income through 'withholding' and not include such income as assessable income in an end-of-year tax return.

At the taxpayer's election, interest income need not be included in an end-of-year tax return, provided that such income is already taxed at source at the 15% rate.[1652] This is a tax loophole. This is because if the taxpayer elects to include interest income in an end-of-year tax return for computing his/her final tax, this income and other assessable incomes (if any) in the tax return will be charged with tax at the rates in the tax-rate schedule (0-37%). Additionally, the taxpayer may elect not to include other income (such as dividends, income from sale of immovable property, etc.) in an end-of-year tax return, provided that such income is already taxed at source.[1653]

The taxpayer's election to have certain incomes taxed at source without including them in an end-of-year tax return generates tax loopholes, inequity in taxation, and revenue loss.

(5) Payers' burden in tax collection

'Withholding' imposes additional costs on 'the payers'. According to Collard and Godwin, compliance costs for employers of 'PAYE' and National Insurance were about £1.3 billion in 1995-96.[1654] They have also found that the costs are high for the small new employer; but for the largest employers, "these costs may be offset by the cash-flow benefits of acting as tax collectors."[1655] Given this, a small business

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[1651] Thai wage and salary earners receive unfair treatment from the withholding system because withholding tax rates on wages and salaries are much higher than those on other incomes.

[1652] Section 48 (3), RCT

[1653] More details can be found in **Appendix XIV to Chapter five.**

[1654] David Collard and Michael Godwin, "Compliance Costs for Employers: UK PAYE and National Insurance 1995-96", Fiscal Studies (1999), vol.22, no.4, p.423

[1655] ibid.p.423

owner may resent the high costs that he/she incurs in acting as "an unpaid tax collector."[1656] This resentment may lead to "an anti-tax mentality and an antipathy to the tax system."[1657] Consequently, a small business owner may not only fail to comply with the requirements that 'PAYE' imposes on him/her but also avoid or evade paying income tax as a personal income taxpayer.[1658]

Under Thai and UK laws, 'the payers' will be given penalties if they fail to withhold tax at source and to remit the tax withheld to the governments.[1659] The imposition of penalties is not only a measure to prevent 'the payers' from non-compliance with the 'withholding' rules but also an incentive to ensure that they will comply with the rules promptly and accurately.

9.2 Improvement in 'withholding' in both countries

9.2.1 Improvements in the interests of tax-gatherers and taxpayers

'Withholding' will benefit to tax-gatherers and taxpayers more if (a) more items of income are taxed at source, (b) withholding tax rates are the same for all types of income, and (c) withholding tax rates are equal to those in the tax-rate schedule.

As regards (a), if 'withholding' in both countries covered as many types of payment as possible, this would:

- minimize tax evasion (by failing to report or underreporting income),
- provide less opportunity for tax avoidance and for corruption,
- bring about tax equity,
- reduce administrative costs in collecting tax and in preventing and detecting tax avoidance and evasion, and
- improve revenue collection.

As regards (b), as we saw, many different withholding tax rates make 'withholding' complex, which increase administrative costs, lead to horizontal inequity, and provide an opportunity for resource reallocation to benefit from lower

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[1656] Sandford, op.cit.(note58), pp.155-156
[1657] ibid.p.155
[1658] ibid.p.156
[1659] More details can be found in **Appendix XV to Chapter Five.**

withholding tax rates. Therefore, if 'withholding' covered payments extremely extensively with the same tax rates, this would:

- lower administrative costs,
- reduce horizontal inequity,
- discourage resource reallocation or close tax loopholes,
- minimize revenue loss resulting from the Thai taxpayer's election not to include income taxed at source in an end-of-year return, and
- improve revenue collection.[1660]

As regards (c), to remove difference in withholding tax rates, withholding tax rates for all types of payment should be equivalent to rates in the tax-rate schedules. In Chapter Two, a system of two tax-rate schedules is proposed. The proposed schedule for low-income groups contains two rates (0% and 8%), whilst the proposed schedule for high-income groups also contains two rates (8% and 35%). On this basis, all payments for low-income groups should be taxed at source at the rate of 8%. Meanwhile, all payments for high-income groups should also be taxed at source at the rate of 8%. This proposed way of withholding at source is likely to help resolve the problem of difference in withholding tax rates.

However, to make the amount of tax withheld be equivalent to final tax liability, 'withholding' at source from wages and salaries should be done on a cumulative basis and taxed at two rates (0% and 8%) in the proposed schedule for low-income groups or at two rates (8% and 35%) in the proposed schedule for high-income groups. On this basis, people whose employment income is taxed at source should not be required to complete and file end-of-year tax returns. The lack of any requirement for completing and filing tax returns will not only be convenient but also reduce compliance costs for taxpayers. It will also reduce administrative costs for checking tax returns.

However, wage and salary earners who have income from other sources, the self-employed, those with complex financial affairs, those with fluctuating income and those with multiple sources of income should still be required to complete and file end-of-year tax returns. This is because income of these groups may sometimes be taxed at source at the proposed rate of 8% and not taxed on a cumulative basis.

9.2.2 Improvements for reduction in burdens on 'the payers'

To lessen additional costs on 'the payers', (a) withholding tax rates should be the same for all types of income; and (b) there should be measures to reduce the degree of complexity in 'withholding'.

As regards (a), no difference in withholding tax rates would reduce the payers' costs in making 'withholding'. Low compliance costs would further reduce the payers' resentment and resistance to complying with the rules concerned.

As regards (b), reducing the complexity in 'withholding' would reduce compliance costs for 'the payers', and prevent the payers' failing to meet their obligations. Presently, there are at least two measures to help achieve these goals, i.e.

- the provision of 'tax codes' and 'tax tables', and
- the filing of withholding tax return via the Internet and computer software.

In the UK, the Revenue provides employers with a 'tax code' for each employee. A 'tax code' represents the amounts of allowances and reliefs that the employee is entitled to.[1661] Employers have to use 'tax codes' along with a set of 'tax tables' provided by the Revenue in calculating the amount of tax to be withheld.[1662] Regarding 'tax tables', one notes,

> "The tables operate on a cumulative basis. For each week or month they show, by reference to each code, the cumulative amount of tax due from the beginning of the tax year in respect of the cumulative emoluments from the beginning of the tax year. Thus the tax to be deducted in a particular week or month is the difference between the amount shown in the tables for that week or month and the cumulative amount of tax deducted in previous weeks or months."[1663]

The use of 'tax codes' and 'tax tables' helps employers to deduct the correct amount of tax from employees' earnings at source.[1664] The RD should adopt the system of 'tax codes' and 'tax tables' into the Thai withholding system. The adoption would reduce compliance costs and prevent employers making incorrect deductions.

[1660] In 2000, 90% of PIT revenue in Thailand was derived from 'withholding'. (Source: The RD)
[1661] Simon Direct Tax Service, op.cit.(note149), p.5106
[1662] ibid.p.5106
[1663] ibid.p.5106

Regarding filing of withholding tax returns via the Internet and computer software, the Thai payers are allowed to file withholding tax returns together with attachments (or the details of tax deducted at source) on computer diskette or CD-ROM. In the UK, small employers are now required to file their end-of-year PAYE returns via the Internet.[1665] Larger employers (i.e. those with 250 or more employees)[1666] are required to file their end-of-year PAYE returns via the Internet as from 2004/05.[1667] This electronic means will be available to everyone by at the latest 2010.[1668]

To encourage the use of electronic means, small employers who filed their end-of-year PAYE returns via the Internet in 2000/01 and paid any tax due electronically were given a discount of £50.[1669] Thailand should adopt this way of subsidising internet filing.

As indicated earlier, Thai and UK rules on 'withholding' can be found in many tax statutes and delegated legislation. One tax Act would ease administration and make it convenient for 'the payers' to comply with the rules. Any changes (e.g. the amendment of withholding tax rates) should fit into this proposed Act. However, administrative bodies should be empowered by this Act to make delegated legislation, such as technical rules regarding conditions or directions for tax administration.

Furthermore, the law should not require an individual to deduct tax if it is inconvenient for the payment to be taxed at source (e.g. payments for sale of goods). Moreover, the law should allow the private sector (such as a company or any juristic person who is subject to corporation tax) to be entitled to subtract the costs incurred in 'withholding' from its profit for the purposes of corporation tax. Such costs may be fixed as a percentage of the amount of tax withheld by the private sector in a tax year (e.g.1%). This would obtain better voluntary compliance of 'the payers'.

[1664] ibid.p.5106
[1665] Arnold Homer and Rita Burrows, Tolley's Tax Guide 2003-04 (London: LexisNexis UK, 2003), 3.
[1666] Melville, op.cit.(note541), p.107
[1667] Homer and Burrows, op.cit.(note1665), p.3
[1668] ibid.p.3
[1669] Homer and Burrows, op.cit.(note1113), p.xli

Finally, if governmental agencies are 'the payers', they should be required to withhold tax from all types of payment.

10. Self-assessment

10.1 Features, advantages and disadvantages

In Thailand, a person whose assessable income exceeds a specified amount (e.g. a single person deriving exclusively income from employment exceeds 50,000 baht)[1670] has to file an end-of-year tax return and pay his/her income tax (if any) to the tax authorities not later than 31 March following the end of the tax year.[1671]

Thai people whose assessable income is lower than a specified amount are not required to file end-of-year tax returns. This can move the poorest group from the income-tax system. Additionally, government resources are not used to deal with the large number of tax returns that would otherwise be filed by the poorest people and which would lead to complexity and increased cost of tax administration without producing a large amount of tax revenue.

When the assessment officer is of the opinion that a person has reported false or inadequate information in a tax return or has failed to file a tax return, he has the power to issue a summons requiring the presence of such a person or a witness for examination, and to order either of them to produce books of account, documents or other relevant records for inspection.[1672] After taking such actions, the assessment officer has the authority to make tax assessment and give notice of any additional amount of tax or the amount of tax payable.[1673] Within 30 days from the date of receiving notice from the assessment officer, a taxpayer must either pay tax according to the tax assessment (together with any penalty and surcharge) or file an appeal against the assessment.[1674]

[1670] More details can be found in **Appendix XVI to Chapter Five.**

[1671] The Thai tax year begins on 1st January and ends on 31st December.

[1672] Sections 19 and 23, RCT

[1673] Sections 20 and 24, RCT

[1674] Sections 18 ter, 20 and 24, RCT

In the case of an appeal, this must be filed with the Tax Appeal Committee. If disagreeing with the ruling of the Tax Appeal Committee, the taxpayer may bring the case to the Central Tax Court and then the Supreme Court.

In the UK, only those with high income and complex financial affairs are required to complete and file tax returns.[1675] Under the UK self-assessment system, the Revenue sends Self-assessment tax returns to the people mentioned above[1676] after the end of the tax year (after 5 April).[1677] People who receive Self-assessment tax returns have two ways to deal with such returns.

First, if they want the Revenue to calculate income tax for them, they must fill the information on their taxable income from all sources and their claims for allowable expenses, reliefs and allowances on tax returns (without tax computation) and send them back to the Revenue before 30 September following the end of the tax year.[1678]

Secondly, if taxpayers are willing to calculate their own tax liability[1679], they must complete and send back their tax returns to the Revenue before 31 January following the end of the tax year.[1680]

In both cases, the deadline for payment of the tax is 31 January following the end of the tax year.

The Revenue has the right to correct minor errors based on the information provided in the tax return within 9 months of the taxpayer's sending in the tax return.[1681] In this case, the taxpayer can object to such amendment.[1682]

Additionally, the Revenue can make an inquiry into the tax return within one year from the 31 January filing date.[1683] Based on such an inquiry, the Revenue can make an assessment to recover the loss of tax if the Revenue has found that the taxpayer has underpaid tax because he/she has given inadequate information in the tax return or is fraudulent or negligent, e.g. under-reporting income or over-claiming reliefs.[1684] In certain circumstances, taxpayers can appeal against such

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[1675] More details can be found in **Appendix XVI to Chapter Five.**

[1676] People who have taxable income but do not receive Self-assessment tax returns must notify the Revenue within 6 months from the end of the tax year, so that the Revenue can send them tax returns.

[1677] The UK tax year begins on 6 April and ends on 5 April of the following year.

[1678] Section 9 (2), TMA

[1679] Details of how to work out the tax liability and examples of tax calculation can be found in **Appendix XVII to Chapter Five** and **Appendix VI to Chapter Two.**

[1680] Section 8 (1), (1A) and (5), TMA

[1681] Melville, op.cit.(note541), p.13

[1682] Sinclair, op.cit.(note1627), p.248

[1683] Section 9A, TMA

[1684] Melville, op.cit.(note541), p.14

assessment.[1685] In cases where the taxpayer has not submitted the tax return within the specified period, the Revenue has the right to make an estimated assessment.[1686]

The UK's Self-assessment is applied more efficiently than Thailand's Self-assessment. Evidence for this is the number of people filing end-of-year tax returns in comparison to the number of population and working people. The table of comparison below will illustrate this point.

Table 5.3: Thailand's data[1687]

Years	Number of Population (million)	Number of Working People (million)	Number of People Filing Tax Returns (million)
1995	59.45	32.57	4.7
1998	60	30	Less than 5
2002	62.19	33	4.3

At the near time, there were 58.8 million people living in the UK in 2001 (36.1 million people in working age).[1688] As noted earlier, most people whose income tax is withheld by PAYE do not have to complete and file end-of-year tax returns. Nevertheless, there were more than 9.15 million people[1689]filing end-of-year tax returns in 2001-02.[1690] This datum is not much different from that in 1996-97(the first year of the introduction of Self-assessment). In that year, 9 million people filed end-of-year tax returns.[1691]

Advantages of 'Self-assessment'

'Self-assessment' benefits both tax-gatherers and taxpayers as discussed below.

[1685] Melville notes that "appeals are heard initially by the General Commissioners or the Special Commissioners but may progress to the Courts." (ibid.p.14)

[1686] Sinclair, op.cit.(note1627), pp.248-249

[1687] **Source**:

For year 1995: Prapai Arayarangsarid, "The use of Information Technology in the Tax System", RD Tax Journal, Year 44, Issue 9, September, 1997, 115.

For year 1998: The World Bank, op.cit.(note262), p.27

For year 2002: The Bank of Thailand, op.cit.(note258), p.1; and Fiscal Policy Office, Ministry of Finance, as referred to in Daily News, on 29th January, 2002, p.9

[1688] The Office for National Statistics, op.cit.(note751), p.2

[1689] Around 8.5, 9.3 and 9.3 million people were required to file end-of-year tax returns in 2002-03, 2003-04, and 2004-05 respectively. **Source**:

(1)The Office for National Statistics, UK2003-The Official Year book (London: TSO, 2002), 353.

(2) "..................................", UK2004-"..", 2003), 358.

(3) "..................................", UK2005-"..", 2004), 372.

[1690] Lymer, et al., op.cit.(note120), p.12

Benefits to tax-gatherers

The income tax of people with a high income and multiple sources of income or of those with complex financial affairs cannot accurately be dealt with by 'withholding'. These people are therefore required to make adjustment to the amount of their tax already withheld by completing and filing end-of-year tax returns. The taxpayer's declaration of income from all sources and tax computation at the end of tax year ensures payment of the correct amount of tax.[1692]

James and Nobes point out that "without self-assessment a great deal of work would remain with the Inland Revenue."[1693] From the UK experience, the Revenue were entirely responsible for the assessment of an individual's tax liability prior to the tax year 1996/97. The shift of responsibility for tax assessment from the Revenue to the taxpayer under 'Self-assessment' saves administrative costs.[1694] Additionally, 'Self-assessment' probably makes tax administration more efficient because the Revenue have more time to check whether or not taxpayers are complying with the tax law.[1695] 'Self-assessment' also improves the government's cash flow because tax payments are made promptly by taxpayers on the filing date.[1696]

Benefits to taxpayers

'Self-assessment' makes the income-tax system fairer for taxpayers. As Morse and Williams note:

> "The aim of self-assessment is to transfer to the taxpayer any decision about the extent to which something should be taxed. Decisions about the relevance of any tax provision to a set of facts, or of interpretation and application of the law to those facts, is for the taxpayer."[1697]

It is also argued that Self-assessment reduces compliance costs for British taxpayers. From the UK experience, prior to the introduction of Self-assessment, "many taxpayers had to contend with several different tax districts making

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1691 L.Chennells, A.Dilnot and N.Roback, A Survey of The UK Tax System (updated August 2000)http://www.ifs.org.uk/taxsystem/taxsurvey.pdf, p.6

1692 Melville, op.cit.(note541), p.21

1693 James and Nobes, op.cit.(note5), p. 202

1694 Nightingale, op.cit.(note65), p.16

1695 Shipwright and Keeling, op.cit.(note182), p.35

1696 Whitehouse, et al., op.cit (note549), p.16

1697 Morse and Williams, op.cit.(note15), pp.38-39 assessments on particular types of income, sometimes from opposite ends of the country."[1698] Under 'Self-assessment', the taxpayer deals with one tax office[1699]because he/she reports all his/her income from different sources and then calculates his/her own tax liability in one tax return which will be submitted to one tax office. On this basis, the compliance cost incurred by the taxpayer is now less than it was in the past.[1700]

Disadvantages of 'Self-assessment'

The above advantages may be undermined by the following disadvantages.

(1) Taxpayer's burden

'Self-assessment' imposes compliance costs, which includes time and money spent in completing tax returns and traveling to tax offices. Completing the tax return is not "a simple exercise."[1701] This is because taxpayers must have basic knowledge of tax laws and of arithmetic. It is possible that compliance costs are costly for those who have neither knowledge of tax laws nor competence in arithmetic and for those who have complex tax affairs because these groups may have to employ tax advisers to help complete their tax returns.

The UK tax return is more complicated, confusing, difficult and costly to complete than the Thai tax return. This is because the UK tax legislation is more complex than the Thai tax law. The complicated tax return makes it more difficult to complete and to check, which increases compliance and administrative costs.

In Thailand, an end-of-year tax return for employment income has one page, and there is a one-page tax calculation guide. An end-of-year tax return for incomes other than employment income has four pages, and there is a four-page tax calculation guide. Meanwhile, the UK end-of-year tax return has a number of pages. For example, the British taxpayers received "a very hefty package from the Post Office [for the tax year 2000-2001], with the tax calculation guide being expanded from last year's eleven pages to twenty nine."[1702]

[1698] Foreman and Mowles, op.cit.(note574), p.41
[1699] ibid.p.41
[1700] Sue Green, "Self-assessment: A New Era for United Kingdom Taxpayers, But What About the Costs", British Tax Review 1996 (London: Sweet&Maxwell, 1996), p.109
[1701] ibid.p.145
[1702] Homer and Rita Burrows, op.cit.(note1113), pp.1-2

Under Thai and UK laws, a taxpayer will be given penalties if he/she fails to comply with the 'Self-assessment' rules, e.g. filing an incorrect end-of-year tax return, or failing to file an end-of-year tax return and to pay tax.[1703]

Under 'Self-assessment', taxpayers must also keep accounts and records that help them to complete or correct their tax returns. Information contained in such accounts and records will also be useful for the taxpayer to answer the tax-gatherer's enquiries and to contend/appeal against the tax assessment when the assessment officer believes that there is false or inadequate information in the tax return. However, keeping proper accounts and records increases compliance costs. Under Thai law, there is no provision to impose a penalty in the case of failure to keep accounts and records. Under UK law, taxpayers must preserve adequate records for a specified period. If taxpayers fail to keep proper records, they will be penalised.[1704]

(2) Tax evasion and revenue loss

It is argued that 'Self-assessment' provides "a plethora of opportunities to evade."[1705] This argument may be correct for three reasons.

First, 'Self-assessment' gives taxpayers opportunities to control their tax affairs. Therefore, dishonest taxpayers use such opportunities to overstate deductions or not to report income from all sources in tax returns.

Secondly, tax-gatherers do not send tax returns to taxpayers, particularly in Thailand. Therefore,

(a) people who have an income but do not know that they have duties to make 'Self-assessment' innocently fail to file tax returns and to pay tax; and

(b) people who have an income but do not appear on the records of tax-gatherers may dishonestly ignore their duties to file tax returns and to pay tax.

Thirdly, tax evasion by not filing the tax return may happen in Thailand because:

- there is less record-keeping,

[1703] More details can be found in **Appendix XV to Chapter Five.**

[1704] ".."

[1705] Ann Mumford, "Self-assessment for Income Tax: The Relevance of Historical and Constitutional Difference", British Tax Review 1996 (London: Sweet&Maxwell, 1996), 131.

- there are many people having no knowledge of tax laws; and
- there are few checks or lack of competent tax officials to check on the number of people who dishonestly ignore their duties to file tax returns.

10.2 Improvement in 'Self-assessment' in both countries

10.2.1 Reduction in compliance costs

Presently, there are at least three ways of resolving the difficulty of completing tax returns and helping taxpayers with no knowledge of tax laws, namely:

(a) the tax gatherers' assistance with tax calculation,

(b) the provision of tax manuals, and

(c) electronic filing of tax returns and payment.

As regards (a), if British taxpayers want the Revenue to calculate tax for them, they have to fill in the information on tax returns and send them back to the Revenue. Therefore, the RD should adopt this method, which would reduce the difficulty of completing the tax return and lessen compliance costs on Thai taxpayers.

As regards (b), the tax calculation guide, the tax return guide and helpsheets provided by both Thai and UK tax authorities educate taxpayers. A better understanding of tax laws would help taxpayers comply with their obligations voluntarily and complete tax returns accurately and promptly.

As regards (c), Thai taxpayers have been allowed to file end-of-year tax returns and pay the tax electronically, via the Internet, since 2002. British taxpayers can also file Self-assessment tax returns electronically.

To encourage the use of electronic means, "a one-off discount of £10 [was] given to individuals who file their 1999/2000 self-assessment returns over the internet and pay the tax electronically."[1706] Thailand should adopt this method of subsidising internet filing.

However, the existing methods above are unlikely to be enough to reduce the difficulty of completing the tax return and lessen compliance costs. The evidence for this is found in difficulties with the technology. In Thailand, "there was little cross-checking, even of computer-processed returns, and collection and compliance verifications were rudimentary."[1707]

In the UK, "the Revenue's self-assessment computer programme does not always work correctly, particularly where tax has been overpaid."[1708] Whitehouse *et al.* remark that "difficulties with the technology have meant that filing electronically has not yet become a popular option."[1709] (About 1.1 million people filed their tax returns electronically in 2003-04).[1710] It is found that "a shorter self-assessment tax return is being introduced for those with simple tax affairs."[1711]

The following measures are likely to help reduce the difficulty of completing the tax return and lessen compliance costs.

First, legal complexity should be reduced. The two tax-rate schedule system and the abolition of certain tax expenditures as proposed in Chapters Two and Three aim to simplify tax rates and the tax base. The simpler tax legislation will lead to a simpler tax return. The World Bank supports the view that "simplified tax laws facilitate self-assessment, which in turn allows administrators to enforce laws more effectively."[1712]

Secondly, the tax authorities of both countries should continue to improve the system of e-filing.

Thirdly, although keeping accounts and records imposes a burden on the taxpayer, it is useful for the taxpayer to complete or correct his/her tax return. Therefore, the Thai law should impose a penalty in the case of failure to keep accounts and records.

10.2.2 Improvement in taxpayers' voluntary compliance

The following measures would improve taxpayers' voluntary compliance and prevent tax evasion under 'Self-assessment'.

[1706] Homer and Burrows, op.cit.(note1113), p.2
[1707] The World Bank, "Thailand's Troubled Tax Computerization Project", http://www1.worldbank.org/publicsector/egov/Thai_taxcs.htm, as of 15/03/02
[1708] Homer and Burrows, op.cit.(note1113), p.169
[1709] Whitehouse et al., op.cit.(note549), p.17
[1710] The Office for National Statistics: UK 2005, op.cit.(note1689), p.372
[1711] ibid.p.372
[1712] The World Bank, op.cit.(note112), p.61

First, educating people about 'Self-assessment' would help prevent people who have no knowledge of tax laws from ignoring their obligations to file tax returns and pay tax.

Secondly, simplifying tax laws and procedures would also improve taxpayers' compliance and administrative efficiency.[1713]

Thirdly, continuous improvements of the computing system (particularly, an automatic calculation of tax liability and a taxpayer identification numbering system) and the training of tax officials should be made to be capable of checking people who fail to file tax returns.

Fourthly, the existence of penalties for non-compliance with the 'Self-assessment' rules would prevent tax evasion. The imposition of penalties is not only a measure to prevent the taxpayer from non-compliance with the rules but also an incentive to ensure that he/she will comply with the rules promptly and accurately.

Fifthly, imposing penalties upon those who fail to keep proper accounts and records would also prevent tax evasion. In Thailand, most street vendors fail to file tax returns and to pay income tax.[1714] The World Bank proposes that "more stringent rules for record keeping should be introduced, and tax inspectors should be able to impose fines on vendors if they do not keep proper records."[1715]

Sixthly, in Thailand, traders and professionals (such as lawyers, physicians, accountants, and architects) should be required to produce with governmental agencies copies of tax returns and receipts of tax payment at the time of renewing their business or professional licenses. This would prevent these groups from failing to file tax returns or underreporting profits or professional income in tax returns.

Seventhly, Self-assessment tax returns should be sent to people. In the UK, the Revenue send Self-assessment tax returns to people who are required to file the returns. Additionally, British taxpayers who have taxable income but have not been sent tax returns are required to notify the Revenue within six months of the end of the tax year; and "failure to do this will result in penalties and fines on the overdue tax when later discovered."[1716] These help prevent people from omitting their duties

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[1713] ibid.p.7
[1714] Daily News, on 29th January, 2002, p.9
[1715] The World Bank, op.cit.(note262), p.31
[1716] Lymer, et al., op.cit.(note120), p.1/13

to file tax returns and to pay tax. Nevertheless, James and Nobes argue that as the Revenue do not sent tax returns to every taxpayer each year at present, "there must be a much greater temptation not to disclose casual and other receipts in the United Kingdom than in other countries."[1717]

Accordingly, Self-assessment tax returns should be sent to Thai people who have taxpayer identification numbers appearing on the records of the RD and whose taxes are not withheld at source on a cumulative basis.[1718] Additionally, Thai people who have not been sent tax returns are required to notify the RD within a specified period. Penalties should also be imposed for non-compliance.

11. Conclusion

To achieve efficient tax legislation (simple and certain), primary and secondary legislation should be written from a detailed viewpoint with a limited tax policy, and by the Rewrite Project's drafting techniques. The proper parliamentary scrutiny and the public consultation will help improve the quality of primary legislation. The system of codification and the limitation of the scope of secondary legislation will help reduce legal complexity and confusion.

The courts should interpret clear words with strictness to ensure legal certainty. However, a purposive interpretation should be applied where it can prevent tax avoidance. Parliamentary material, explanatory memoranda and purposive statements (if any) would help the courts to interpret ambiguous words and to apply a purposive interpretation.

GAARs (if adopted) must distinguish between acceptable and unacceptable transactions, incorporate a clearance procedure, and restrict discretionary powers. The disclosure rules should not be too widely drawn and frequently amended. In explaining, interpreting and applying the law, the tax authorities should not go beyond the strict letter of the law.

'Withholding'should cover the types of payment extensively with few tax rates. Additionally, reducing the complexity of 'withholding' would reduce compliance costs for 'the payers'. To resolve the difficulty in completing tax returns

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[1717] James and Nobes, op.cit.(note5), p.203

and to improve voluntary compliance under 'Self-assessment', methods, such as e-filing, a less complicated tax return, and simplification of tax laws and procedures, should be introduced and improved.

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[1718] However, Self-assessment tax returns need not be sent to employees whose tax is withheld at source on a cumulative basis equals final tax liability, such as low- and middle-income employees.

Chapter Six: Conclusion

It has been found that the components of substantive PIT law in Thailand and the UK cause conflict between equity and efficiency. This research has proposed and validated theories that (i) optimal tax structures and (ii) efficiency in tax legislation and administration could reduce the conflict.

I. Optimal Tax Structures

The current Thai and UK tax-rate schedules are not highly progressive, i.e. there are few low MTRs and wide tax bands on high incomes, which promote vertical equity/redistribution to some extent, but generate simplicity, reduction in incentives to avoid and evade tax, and reduction in a disincentive effect.

The two tax-rate schedule system is proposed to replace the current Thai and UK tax-rate schedules. This is a structural proposal of optimal statutory marginal tax rates ("OSMTRs"). This system consists of a schedule for low-income groups (which contains two MTRs of 0% and 8%) and a schedule for high-income groups (which contains two MTRs of 8% and 35%). MTRs in both schedules are supposed to be OSMTRs, which would promote efficiency and vertical equity/redistribution to greater extent.

Vertical equity/redistribution would be promoted because the proposed increase in personal allowances and the proposed zero-rate bracket in the proposed schedule for low-income groups would raise the level of income subject to the low or starting rate, which would lower tax burdens on low-income earners. Additionally, tax burdens on (lower) middle-income earners would be reduced because (a) they would receive tax benefits from the proposed increase in personal allowances and the proposed zero-rate bracket, and (b) the tax rate for them would be low (only 8%). Furthermore, the proposed schedule for high-income groups would:

(a) increase the number of highest- or higher-rate taxpayers, and

(b) impose greater tax burdens or ATRs on high-income groups by

  (i) preventing high-income groups from receiving the benefit of the low rate in the proposed schedule for low-income groups, especially the 0% rate, and

  (ii) reducing incentives for high-income groups to avoid or evade tax.

Simultaneously, the two tax-rate schedule system would promote efficiency. This is because low and few MTRs together with wide and few tax bands in both schedules would reduce incentives to avoid and evade tax, and be unlikely to create disincentive effects. Furthermore, few MTRs and tax bands in the two tax-rate schedule system would reduce administrative and compliance costs because they generate simplicity. Simplicity in the taxing process will also occur when low-income earners are moved out of the PIT system as a result of the proposed zero-rate bracket along with the proposed increase in personal allowances. A reduction in rate differentials between earned and unearned income by the use of the two tax- rate schedules would also generate simplicity.

Structural reliefs and non-structural reliefs (or tax expenditures) under Thai and UK laws narrow the income-tax base, and reduce the taxable income and tax burden on the poor. However, tax reliefs cause (a) horizontal inequity, (b) vertical inequity, (c) the negation of tax progressivity, and (d) inefficiency of taxation. This is because (a) they are only available to particular types of individuals (except for the basic allowance); (b) they reduce the taxable income and tax burden on the rich; (c) they give the rich a greater proportionate reduction in the tax burden than the poor; and (d) they lead to revenue loss, complicate tax legislation, provide tax loopholes, and distort resource allocation.

The income-tax base should be broadened in line with the CIT idea which requires all forms of economic accretion to be included in the income-tax base. Broadening the tax base can be implemented by (a) defining income subject to tax broadly and (b) limiting the use of tax reliefs. The two measures will generate an optimal tax base, which would generate both equity and efficiency.

The broad definition of income can achieve equity because it prevents vertical and horizontal inequity, closes loopholes for tax avoidance, and brings more high-income taxpayers. Simultaneously, it can achieve efficiency because it generates a great amount of tax revenue.

Tax reliefs should erode the tax base for low-income earners rather than doing so for high-income earners. This would promote equity and efficiency simultaneously because it would (a) reduce horizontal and vertical inequity, (b) reduce the tax burden on the poor, (c) increase the tax burden on the rich, and (d) generate more tax revenue, simplify tax legislation, and reduce tax loopholes and distortion in resource allocation.

The above proposal can be implemented by maintaining and increasing personal allowances to cover private consumption expenditures per capita (under both laws) and to be in line with price inflation (under Thai law), phasing out personal allowances for the rich (under both laws), abolishing a standard deduction of expenses (under Thai law), applying a deduction of actual expenses for all sources of income (except for savings and dividends incomes) (under both laws), improving and enforcing account and record keeping (under Thai law), abolishing certain tax expenditures (under both laws), maintaining certain tax expenditures (under both laws), and discontinuing new tax expenditures that cannot be justified on the grounds of equity and expediency (under both laws).

The Thai joint-taxation system can succeed in satisfying equity more easily than it leads to efficiency. To strike a balance between equity and efficiency, joint taxation should increase efficiency while sustaining equity. Four methods can achieve this goal.

1st method

The discretion of the assessment officer under the rules of separate assessment should be reduced to promote more efficiency. Additionally, the rules of wife's election for separate taxation should be abolished because they impede equity and cannot completely fulfil the efficiency requirement.

2nd method

The tax-rate schedule which contains low and few MTRs, and wide and few tax bands should be used with joint taxation because it would reduce disincentives for married couples to engage in economic activities. The proposed two tax-rate schedules are consistent with this proposal. Additionally, MTRs and tax bands in the proposed schedule for low-income groups would lower tax burdens on low-income and (lower) middle-income married couples.

3rd method

An allowance for the taxpayer's spouse should be provided only to a married person whose spouse stays at home because of old age, poor health, or the necessity of staying at home to care for relatives, because this will help reduce inequity in joint taxation. This allowance should not be given to a married person whose spouse chooses to stay at home to enjoy leisure or to do housework because if this allowance were provided to such a married person, this might discourage a non-earning spouse from participating in the labor force.

4th method

Thai anti-avoidance rules are not extensive enough to close loopholes to avoid tax by shifting investment income from parents to children. The rules on settlements and outright gifts under UK law should be adapted to Thai law.

Meanwhile, the UK individual-taxation system can lead to efficiency rather than bring about equity. To achieve a balance between equity and efficiency, individual taxation should reduce inequity while maintaining efficiency. There are three methods of achieving this goal.

1st method

The proposed two tax-rate schedules should be used with the individual-taxation system. This is because low and few MTRs, and wide and few tax bands in the proposed two tax-rate schedules could:

- reduce the different treatment of two low-income married couples where the distribution of income between both couples is different,
- reduce the different treatment of two high-income married couples where the distribution of income between both couples is different, and
- create incentives to work and discourage tax avoidance and evasion.

2nd method

An additional personal allowance should be available to a childless married person whose spouse stays at home but is unable to do housework because of old age, poor health, or the need to stay at home to care for a relative. It should not be available to a childless married person whose healthy spouse chooses not to earn but to stay at home.

3rd method

Rules on settlements and outright gifts help prevent tax avoidance by the transfer of property between spouses and between civil partners and by the transfer of property to an unmarried child under 18, a married child under 18 or a child over 18.

II. Enhancement of efficiency in tax legislation and administration

Simple and certain tax legislation, and simple, certain and convenient methods of tax collection are efficient tax legislation and administration, which encourage efficiency of taxation and further promote equity.

To achieve simple and certain tax legislation, Thai and UK primary and secondary tax legislation should be written from a detailed viewpoint with a limited tax policy, and by drafting techniques including:

- not be written in a convoluted style and too tight, nor contain jargon and archaic words and very long sentences,
- be written in pain and unambiguous language (e.g. using one word in place of several words, simple and well-understood vocabulary and syntax), with a clear and consistent structure, and in short sentences supplemented by a splitting technique.

Furthermore, changes to primary legislation should be made where clearly inevitable and necessary. Moreover, secondary legislation should not extend to the important tax matters, and its scope should be limited only to technical rules for supplementing the operation of primary legislation.

There should be an annual compulsory Act relating to taxation passed by the Thai Parliament. This would make Thai tax legislation more flexible to respond to social and commercial changes and more equitable because allowances and bands for inflation would be adjusted every year.

The problem of lack of proper parliamentary scrutiny of UK Finance Acts could be solved by allowing the House of Commons to have more time to debate the Pre-Budget Report, conferring powers on the House of Lords to initiate or amend tax provisions, establishing a Parliamentary Committee to take parliamentary pre-legislative scrutiny (if members of Parliament had no or little time to take pre-legislative scrutiny).

The system of codification is more likely to satisfy simplicity and certainty than the system of consolidation. This is because codification resolves the problem of lack of structure and the problem of the multiplicity of statute laws dealing with a particular tax.

A strict interpretation ensures legal certainty; therefore, the Thai and UK courts should interpret clear words with strictness. A purposive interpretation can help the UK courts to prevent tax avoidance, but it results in legal uncertainty. The Thai courts should adopt this approach where a strict interpretation would lead to injustice (because of not preventing tax avoidance). Parliamentary material, explanatory memoranda and purposive statements (if any) will help the courts to interpret ambiguous words and to apply a purposive interpretation because they can help identify the legislative intention.

To reduce uncertainty and discretionary powers, GAARs (if adopted in Thailand or the UK) must distinguish between acceptable and unacceptable transactions, incorporate a clearance procedure, and restrict discretionary powers. To avoid uncertainty and complexity, the UK disclosure rules should not be too widely drawn and frequently amended.

To ensure legal certainty, in making statements for explaining, interpreting and applying the law, neither the Thai nor the UK tax authorities should go beyond the strict letter of the law. Furthermore, the tax authorities should consult parliamentary material and explanatory memoranda (if any) to help interpret tax legislation in the case of ambiguity. Moreover, the UK Revenue should derive legal power from an Act of Parliament in making extra-statutory concessions. There should also be provisions in the Thai and UK tax Acts to stipulate conditions on applying and giving formal post-transaction rulings and pre-transaction rulings.

'Withholding' in Thailand and the UK should cover the types of payment extremely extensively with few tax rates. This would make tax laws fairer, minimize tax evasion, provide less opportunity for tax avoidance and for abuse of the tax authorities' power, reduce administrative costs in collecting tax and in preventing and detecting tax avoidance and evasion, and improve revenue collection. 'Withholding' from wages and salaries should be done on a cumulative basis and at the rates in the proposed two tax-rate schedules. This would help the amount of tax withheld equal final tax liability.

Reducing the difference in withholding tax rates and the complexity of 'withholding' would reduce compliance costs for the payers and prevent them from failing to meet their obligations. Methods that should be implemented include subsidizing internet filing, the rules on 'withholding' being put into one tax statute, and a company being allowed to subtract the costs incurred in 'withholding' from its profit for the purposes of the corporation tax.

The Thai and UK self-assessment system increases costs in the private sector. Methods that could help taxpayers to complete tax returns include subsidizing and improving internet filing, simplifying legislation, and enforcing taxpayers to keep accounts and records.

Self-assessment may lead to tax evasion and revenue loss. Methods that could encourage voluntary compliance include educating Self-assessment, simplifying tax laws and procedures, and improving the computing system.
